TRUSTEE INVESTMENT POWERS

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ALBERTA LAW REFORM INSTITUTE

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The Institute's office is located at:

402 Law Centre,
University of Alberta,
Edmonton, Alberta, T6G 2H5.

Phone: (780) 492-5291;
Fax: (780) 492-1790.

The Institute's electronic mail address is:

reform@alri.ualberta.ca.

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CITATIONS AND ABBREVIATIONS

FREQUENTLY CITED STATUTES

The full citation for most of the statutes referenced in this report is given in the relevant footnotes. However, the full citation for the following two statutes, which are referred to frequently in the report, is not given in footnotes.

Dependent Adults Act, R.S.A. 1980, c. D-32
Trustee Act, R.S.A. 1980, c. T-10

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Cowan v. Scargill [1984] 2 All E.R. 750 (Ch.D.)
Fales v. Canada Permanent Trust Co. [1977] 2 S.C.R. 302
Harvard College v. Amory 26 Mass. (9 Pick.) 446 (1830)
Haslam v. Haslam (1994), 114 D.L.R. (4th) 562 (Ont. Gen. Div.)
Jones v. AMP Perpetual Trustee Company [1994] 1 N.Z.L.R. 690 (H.C.)
Jonsson v. Perrault [1998] A.J. No. 1235, online: QL (CJ)
Learoyd v. Whitely (1887), 12 App. Cas. 727
Nestle v. National Westminster Bank [1994] 1 All E.R. 118 (C.A.)
Pocock v. Reddington (1801), 31 E.R. 862
Re Barabash Estate [1999] A.J. No. 1012 (Q.B.), online: QL (CJ)
Re Janes, 681 N.E.2d 332 (N.Y.C.A. 1997)
Re Miller Estate (1987), 26 E.T.R. 188 (Ont. Surr. Ct.)
Re Turnbull [1997] A.J. No. 1129 (Q.B.), online: QL (CJ)
Sharpe v. McCarthy (1994), 94 B.C.L.R. (2d) 384 (C.A.)

WORKS CITED

The footnotes in this report refer to books, articles, law reform reports and other secondary sources by means of the abbreviated references in the following table.

Footnote Reference	Full Citation
ALRI 1999	Alberta Law Reform Institute, *Trustee Investment Powers*, Consultation Memorandum No. 7 (Edmonton: ALRI, 1999)
BCLI 1998	British Columbia Law Institute Trustee Act Modernization Committee, *Consultation Paper on Trustee Investment Powers* (Vancouver: BCLI, 1998)
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Footnote Reference	Full Citation
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MacQueen 1986	Jason MacQueen, "Beta is Dead! Long Live Beta!" in Joel M. Stern & Donald H. Chew eds., *The Revolution in Corporate Finance* (Oxford: Basil Blackwell, 1986)
McDermott 1996	P.M. McDermott, "Trustee Investment Law Reform" (1996) 70 Aust. L.J. 801
MLRC 1982	Manitoba Law Reform Commission, *Report on Investment Provisions under "The Trustee Act"* (Winnipeg: MLRC, 1982)
MLRC 1999	Manitoba Law Reform Commission, Report # 101, *Trustee Investments: The Modern Portfolio Theory* (Winnipeg: MLRC, 1999)
Quebec Commissioners 1970	J. K. Hugessen, "Trustee Investments: Report of the Quebec Commissioners" in ULCC 1970, Appendix D, 115
Quebec Commissioners 1966	Louis-Philippe Pigeon & J. W. Durnford, "Trustee Investments" in ULCC 1966, Appendix Q, 106.
ULCC 1957	*Proceedings of the Thirty-Ninth Annual Meeting of the Conference of Commissioners on Uniformity of Legislation in Canada* (ULCC, 1966)
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ULCC 1970	*Proceedings of the Fifty-Second Annual Meeting of the Conference of Commissioners on Uniformity of Legislation in Canada* (ULCC, 1970)
Waters 1984	D.W.M. Waters, *Law of Trusts in Canada*, 2nd ed. (Toronto: Carswell, 1984)
Waters 1998	Donovan W.M. Waters, *The Modern Portfolio Theory (or Prudent Investor Rule)*(Winnipeg: Manitoba Law Reform Commission, 1998)

ABBREVIATIONS USED IN TEXT

BCLI	British Columbia Law Institute (successor to LRCBC)
DAA	Dependent Adults Act
LRCBC	Law Reform Commission of British Columbia
LRCS	Law Reform Commission of Saskatchewan
MLRC	Manitoba Law Reform Commission
MPT	Modern Portfolio Theory
NCCUSL	National Conference of Commissioners on Uniform State Laws
ULCC	Uniform Law Conference of Canada
UPIA	Uniform Prudent Investor Act (NCCUSL)
UTIA	Uniform Trustee Investment Act, 1997 (ULCC)

PART I — EXECUTIVE SUMMARY

OVERVIEW

The powers and duties of a trustee with respect to the investment of trust property are governed by the instrument that created the trust. If, however, the trust instrument does not expressly define the scope of the trustee's investment powers, it is defined by section 5 of the *Trustee Act*.

Section 5 is an example of what has come to be known as the *legal list* approach to the statutory definition of trustee investment powers. Under this approach, a trustee may invest trust funds only in types of property (usually securities of one sort or another) identified in the statute, unless the trust instrument provides broader investment powers. The purpose of restricting trustees to investing in the specified types of property is to prevent them from exposing the trust capital to undue risk. The legal list approach developed in the United Kingdom in the nineteenth century. Until the last twenty years or so, trustee statutes in the United Kingdom, Canada, Australia and New Zealand all followed some version of the legal list approach.

Over the last twenty years, and especially in the last five, most Commonwealth jurisdictions have replaced the legal list approach with the *prudent investor* approach. Under the latter a trustee is not restricted to investing in types of property identified in a statutory list. Statutes implementing the prudent investor approach focus on the process by which trustees make investment decisions and stress the importance of considering the interrelationship between different components of the trust portfolio. Instead of attempting to control risk by restricting trustees to a list of ostensibly safe investments, the prudent investor approach emphasizes the importance of intelligent diversification as a means of controlling risk.

The prudent investor approach is an elaboration of an approach called the *prudent man* rule that has long been followed by most jurisdictions in the United States. New Zealand adopted the prudent investor rule in 1988, and all Australian states have now done likewise. It appears that the United Kingdom will soon

replace its version of the legal list approach with the prudent investor rule. Alberta is one of four Canadian provinces–the others being British Columbia, Quebec and Newfoundland–that have not yet adopted either the prudent man rule or the prudent investor rule.

The central recommendation of this report is that Alberta should follow the trend of legislation in other jurisdictions and replace the legal list approach with the prudent investor rule. We make this recommendation not to follow a trend but because we believe that the jurisdictions that have adopted the prudent investor rule have acted on the basis of sound theoretical and practical considerations. Legislation to implement the prudent investor rule in Alberta would take advantage of the Uniform Law Conference of Canada's *Uniform Trustee Investment Act, 1997*.

SUMMARY OF CHAPTERS

Chapter 1–Introduction

This chapter provides a slightly more detailed introduction to the matters discussed in this report than is provided in this summary. It also describes the process that has culminated in the issuing of this report.

Chapter 2–Trustee Investment Powers

This chapter has two main sections. The first describes the existing law relating to trustee investment powers in Alberta. The second provides a brief description of the evolution of legislation relating to trustee investment powers in Alberta and other jurisdictions.

Chapter 3–Analysis and Recommendations

This chapter, which contains all of our recommendations, is divided into three main sections. The first section asks how well the legal list approach can be expected to fare in practice as a means of preventing trustees from exposing the trust to undue risk. The answer is, "not all that well."

The second section contains the report's fundamental recommendation, which is that the legal list approach be replaced with the prudent investor rule

(Recommendation 1). It also contains a recommendation that the prudent investor rule apply to all trusts and to statutes that incorporate the *Trustee Act*'s investment powers by reference, unless the relevant trust instrument or statute expresses a contrary intention (Recommendation 3). There is a specific recommendation that attorneys acting under an enduring power of attorney be subject to the prudent investor rule (Recommendation 2).

The third section deals with the details of implementing the prudent investor rule. For the most part, we recommend enactment of provisions based on the *Uniform Trustee Investments Act, 1997*. There are, however, a few instances where we would not follow the precise wording of the Uniform Act. The principal recommendations in this section are to the following effect, keeping in mind that all of these recommendations would be "trumped" by a contrary intention expressed in the trust instrument:

- Trustees should be able to invest in any type of property, so long as the investment is in accordance with the standards of prudent investment (Recommendation 4).

- Trustees should be directed to invest trust property with a view to obtaining a reasonable return while avoiding undue risk in the context of the overall trust portfolio (Recommendation 5).

- Trustees should be directed to consider specified matters when planning the investment of trust property (Recommendation 6).

- A trustee should not be liable for a loss arising from the investment of trust property if a reasonably skilled and prudent trustee acting in accordance with the standards of prudent investment could have made the decision or followed the course of action that led to the loss (Recommendation 7).

- Trustees should be able to delegate investment authority to agents to the extent that a prudent investor might do so in accordance with normal

investment practice (Recommendation 9). The trustee must exercise prudence in selecting, instructing and monitoring the agent (Recommendation 10).

Other recommendations deal with: quantification of damages (Recommendation 8); liability of a trustee who has delegated investment authority to an agent for the agent's actions (Recommendation 11); actions against the trustee's agent (Recommendation 12); whether investing in mutual funds constitutes delegation of investment authority (Recommendation 13); and registration of securities in the name of the trustee (Recommendation 14).

Appendices

The report concludes with three Appendices. Appendix A sets out the provisions of the *Trustee Act* that would be replaced by legislation implementing our recommendations. Appendix B lists statutes that incorporate the *Trustee Act*'s investment provisions by reference. Appendix C contains of draft legislative provisions based on our recommendations.

PART II — LIST OF RECOMMENDATIONS

RECOMMENDATION No. 1
The legal list approach to default trustee investment powers, as embodied in section 5 of the *Trustee Act*, should be replaced by the prudent investor rule. . . 35

RECOMMENDATION No. 2
The *Powers of Attorney Act* should be amended to make it clear that, unless an enduring power of attorney provides otherwise, the attorney must exercise a power of investment in accordance with the standards of prudent investment as set out in the *Trustee Act*. 42

RECOMMENDATION No. 3
Subject to a contrary intention expressed in a trust instrument or an enactment that defines the investment powers of fiduciaries by reference to the *Trustee Act's* investment provisions, the prudent investor rule should govern investment by all trustees and by such fiduciaries, regardless of whether the trust is created or the enactment is enacted before or after the *Trustee Act* is amended to adopt the prudent investor rule. 46

RECOMMENDATION No. 4
Subject to the terms of the trust, a trustee should be able to invest trust property in any form of property, provided that the investment is made in accordance with the standards of prudent investment as set out in the *Trustee Act*. 49

RECOMMENDATION No. 5
(a) Subject to the terms of the trust, the *Trustee Act* should require trustees to invest trust property with a view to obtaining a reasonable return while avoiding undue risk, having regard to the circumstances of the trust.

(b) The *Trustee Act* should direct trustees to evaluate the expected return and risk associated with investment strategies or decisions within the context of the overall trust portfolio, rather than by focussing on particular investments in isolation.

(c) The *Trustee Act* should require trustees to review the trust portfolio at reasonable intervals for the purpose of confirming that the portfolio continues to be appropriate to the circumstances of the trust. 51

RECOMMENDATION No. 6
Without restricting the matters that a trustee may consider, a trustee should be required to consider the following matters in planning the investment of trust property, insofar as their consideration is consistent with the terms and relevant to

the circumstances of the trust:

(a) the purposes and probable duration of the trust, the total value of the trust's assets, and the needs and circumstances of the beneficiaries;

(b) the duty to act impartially towards beneficiaries and between different classes of beneficiaries;

(c) the special relationship or value of an asset to the purposes of the trust or to one or more of the beneficiaries;

(d) the possible effect of inflation or deflation;

(e) the need to maintain the real value of the capital or income of the trust;

(f) the need to maintain within the portfolio a balance that is appropriate to the circumstances of the trust between
- risk,
- expected total return from income and the appreciation of capital,
- liquidity, and
- regularity of income;

(g) the importance of diversifying the portfolio to an extent that is appropriate to the circumstances of the trust,

(h) the role that different investments or courses of action play within the overall portfolio;

(i) the costs (such as commissions and fees) and expected tax consequences of investment decisions or strategies. 64

RECOMMENDATION No. 7

The *Trustee Act* should provide that a trustee is not liable for a loss in connection with the investment of trust property if the loss arises from a decision or course of action that a reasonably skilled and prudent trustee acting in accordance with Recommendations 5 and 6 might have made or adopted. 74

RECOMMENDATION No. 8

The Trustee Act should provide that in assessing damages payable by a trustee for a loss to the trust arising from the trustee's failure to conform to the standard of prudent investment, a court *may* take into account the overall performance of the investments. 79

RECOMMENDATION No. 9
Subject to a contrary intention expressed in the trust instrument, the Trustee Act should authorize trustees to delegate to agents the degree of authority with respect to investment of trust property that a prudent investor might delegate in accordance with ordinary investment practice. 86

RECOMMENDATION No. 10
The *Trustee Act* should require trustees to exercise prudence in selecting an agent, in establishing the terms of the delegated authority and in monitoring the performance of the agent to ensure compliance with the terms of the delegation. 87

RECOMMENDATION No. 11
The Trustee Act should provide that a trustee who has properly delegated authority to an agent is not liable for the agent's decisions or actions if the trustee has discharged their duties relating to selection of the agent, establishing the terms of the delegated authority, and monitoring the agent's performance. 91

RECOMMENDATION No. 12
The *Trustee Act* should provide that loss suffered by a trust by reason of an agent's breach of a contract with a trustee may be recovered in an action by the trustee or, if the trustee fails to bring an action, in an action by beneficiaries. 94

RECOMMENDATION No. 13
The *Trustee Act* should provide that purchase of securities issued by a mutual fund does not amount to delegation of investment authority by the trustee to the fund manager. 96

RECOMMENDATION No. 14
Section 9 of the Trustee Act should be amended so as to require trustees to ensure, so far as it is possible to do so, that any record evidencing their ownership of securities indicates their status as trustees, without presuming that the record will necessarily be an entry in the securities register of the issuer. 98

PART III — REPORT

CHAPTER 1. INTRODUCTION

A. The Subject of this Report

[1] A *trust* arises where a person[1]–the *trustee*–who is the legal owner of certain property must exercise their rights and powers as legal owner for the benefit of another person or persons–the *beneficiaries* of the trust–rather than for their own benefit.[2] A trust is said to involve separation of *legal* title and *equitable* title to the trust property. The trustee is the legal owner of the trust property but the beneficiaries are the equitable owners.

[2] Broadly speaking, there are two types of trust: (1) a trust deliberately created by person who originally holds both the beneficial and legal title to property and wants to split them up; (2) a trust that arises by operation of law. The latter arises where, by virtue of a statute or judicial decision, the legal owner of property is regarded as holding it on trust for someone else, even though the legal owner might have had no intention of being a trustee. This report focuses primarily on the former sort of trust: one created by the deliberate act of someone who wants to split up the legal and beneficial ownership of property.

[3] Trustees are said to owe *fiduciary duties* to the beneficiaries of the trust, and trustees themselves are sometimes referred to as *fiduciaries*. In a nutshell, this means that trustees are under a strict duty to put their own interests aside when dealing with the trust property and to deal with it with the best interests of the beneficiaries exclusively in mind.

[4] Trustees are not the only sort of fiduciary. Another sort of fiduciary that is relevant to the purposes of this report is a person (or a body of persons) who is

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[1] Actually, it is not uncommon for there to be more than one trustee of a trust.

[2] It is possible for one person to be both a trustee and a beneficiary. For example, *A* may hold property on trust for the benefit of *A* and *B*. This is but one of many subtleties of trust law that are largely ignored in this report.

responsible under a statute for managing funds that belong to some other person or body.[3] In many cases, the statute under which such fiduciaries are acting defines their investment powers by referring to the investment provisions of the *Trustee Act*.

[5] Lawyers refer to a person who creates a trust that comes into effect while the person is still alive (an *inter vivos* trust) as a *settlor* and to a person who creates a trust that comes into effect upon their death as a *testator*. That distinction is not relevant to this report, so we simply refer to the *trust creator*. Similarly, we refer to the document or oral declaration[4] that evidences the trust creator's intention to create a trust and that sets out the terms of the trust as the *trust instrument*. The trust instrument, then, might be a will that takes effect on death or a document or oral declaration that takes effect immediately.

[6] The law of trusts gives trust creators great latitude in formulating the terms of a trust: the set of duties, powers, authorities and discretions that governs the trustee in dealing with the trust property. Subject to broad constraints dictated by considerations of public policy, what the trustee may do, must do or cannot do with the trust property is determined by the trust creator's intentions, insofar as they are revealed by the trust instrument.

[7] One of the principal tasks of most trustees is to invest trust assets. How the trustee should be required to approach this task is the general issue considered by this report. The primacy of the trust creator's intention, as evidenced by the trust instrument, applies to the investment of trust funds as well as to other aspects of a trust's administration. The trust instrument could limit the trustee to investing only in a handful of specifically identified securities or in a somewhat broader but still limited range of assets. At the other extreme, the trust instrument could authorize the trustee to make any investment that the trustee considers appropriate. An intermediate approach might be one in which the trust instrument does not restrict

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[3] It might be asked why these fiduciaries are not trustees if they are managing other persons' money. One reason might be that the fiduciary in question has the authority and power to deal with the other persons' money but is not the legal owner of the money.

[4] Testamentary dispositions (wills) must be in writing and executed with certain formalities. And the intention to create an *inter vivos* trust of land must be evidenced by a writing signed by the alleged trust creator. But an *inter vivos* trust of personal property can be created by an oral declaration.

the trustee to investing in defined classes of assets but specifies standards or criteria that the trustee must apply when investing trust property. The crucial point is that, insofar as the trust creator's intentions regarding the trustee's investment duties and powers are clearly expressed in the trust instrument, they will be enforced by the courts.

[8] The issues under consideration in this project arise primarily in the context of trusts created by trust instruments that do not expressly define the trustee's investment authority and responsibility.[5] The law abhors a vacuum. Therefore, if the trust instrument does not specify the trustee's investment duties and powers, the courts or the legislature must supply a *default rule* that fills the gap. In Alberta the default rule is provided by section 5 of the *Trustee Act*. Section 5 takes what has come to be known as the *legal list* approach to default trustee investment powers. Under this approach, in the absence of a broader investment authority in the trust instrument, the trustee is confined to investing trust funds in assets that fall within categories specified by the Act.

[9] The fundamental recommendation of this report is that the legal list approach be replaced with a more flexible approach commonly known as the *prudent investor* rule. Rather than categorizing certain forms of property as permitted trustee investments and prohibiting investment in other forms of property, the prudent investor rule focuses on the *process* of making decisions with respect to the investment of trust property. The rule emphasizes the importance of establishing an investment strategy with risk and return objectives that reflect the purposes and circumstances of the trust. While the legal list approach attempts to limit risk by prohibiting trustees from investing in forms of property that the authors of the list have determined to be inherently speculative or risky, the prudent investor rule focuses on *diversification* as a key strategy for managing risk.

[10] Having recommended that the legal list approach be replaced with the prudent investor approach, the report goes on to consider and make recommendations regarding a number of subordinate issues. These issues relate to

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[5] We say they arise "primarily" in the context of trust instruments that do not precisely define the ambit of the trustee's investment authority because we are concerned to some extent with enactments that define the investment powers of fiduciaries other than trustees by referring to the investment provisions of the *Trustee Act*.

such matters as whether there should be any contexts in which the prudent investor rule should not replace the legal list approach, how the prudent investor standard should actually be expressed in legislation, and the extent to which trustees should be permitted to delegate investment decisions to expert agents.

B. About our Project

[11] As is discussed in more detail in Chapter 2, over the last few years the majority of Canadian provinces, as well as many US and Commonwealth jurisdictions have adopted the prudent investor approach. And a number of jurisdictions that still follow the legal list approach seem poised to replace it with the prudent investor rule.

[12] In 1998 Alberta's Minister of Justice invited the Alberta Law Reform Institute to undertake a project that would consider the possible replacement of the legal list approach with the prudent investor approach. The Institute agreed to undertake the project, but other commitments prevented us from starting work on the project until the summer of 1999.

[13] Our first step was to establish our Project Committee. We then prepared a consultation memorandum, which was circulated in September 1999. We sent unsolicited copies of the memorandum to various individuals and organizations whom we presumed would have an interest in the subject. In addition, we sent notice of the consultation memorandum to members of the Canadian Bar Association's Calgary and Edmonton Wills and Estates sections and to members of the Edmonton Estate Planning Council. The notice resulted in requests for the consultation memorandum from about sixty-five individuals and organizations.

[14] The consultation memorandum set out nineteen specific issues upon which readers were invited to comment. The memorandum described two or more alternative approaches for each issue and, in most cases, indicated the Project Committee's tentative preference as between the alternatives. On the fundamental issue, the memorandum indicated that the Project Committee favoured adoption of the prudent investor rule.

[15] We received seven written responses to the consultation memorandum, six of which supported the concept of replacing the legal list approach with the prudent

investor approach. Although few in number, the written responses were very helpful to the Project Committee and the Institute Board in considering the issues and formulating the recommendations found in this report.

Chapter 2. Trustee Investment Powers

[16] This chapter is divided into two main sections. Section A describes the existing law relating to trustee investment powers in Alberta. Section B describes how Alberta's law regarding trustee investment powers came to be the way it is today through migration and evolution, and describes recent developments of the law in other jurisdictions.

A. Trustee Investment Powers in Alberta

1. The Primacy of the Trust Instrument

[17] Section 5 of the *Trustee Act* provides that a "trustee may invest" trust funds in any of the types of investment listed in the section's sixteen clauses. It is crucial to keep in mind the point that we have already made, which is that the investment powers in section 5 are default powers that apply only if the trust instrument itself does not provide a different range of investment powers. The instrument could provide more expansive or more restrictive investment powers. Or it might provide investment powers that are broader than those conveyed by section 5 but also provide the trustee with fairly specific constraints or instructions as to the method of making investment decisions. The primacy of the trust instrument is made clear by section 10:

> (1) The powers conferred by this Act relating to trustee investments are in addition to the powers conferred by the instrument, if any, creating the trust.
>
> (2) Nothing in this Act relating to trustee investments authorizes a trustee to do any thing that he is in express terms forbidden to do or to omit to do any thing that he is in express terms directed to do by the instrument creating the trust.

[18] Given the primacy of the trust instrument when it comes to investment of trust funds, it is reasonable to ask whether it really matters whether section 5's investment powers are optimal or not. After all, any trust creator who wants their trustee to have broader investment powers than would be provided by section 5 can easily provide broader powers in the trust instrument.

[19] While remaining agnostic for the moment on whether the investment powers stipulated by section 5 are optimal, we will indicate several reasons why it matters whether they are. First, there are many situations where there is no realistic

opportunity for a trust creator to clothe the trustee with investment powers other than those provided by the default rule. Many trust instruments–"home-made" wills are a notable example–are not drafted by lawyers, and in such cases the trust creator may well fail to consider the appropriate scope of the trustee's investment powers. There may not even be a trust creator. Where a trust is created by operation of law, or where duties analogous to those of trustees are imposed by an enactment, there is no trust creator to choose investment powers other than the default investment powers.

[20] A second reason why the default rule matters is one that applies whenever the legislature or courts must supply a default rule that will govern a relationship unless someone chooses different rules to govern the relationship.[6] All else being equal, it makes sense for the legislature or courts to choose a default rule that most participants in such relationships would choose if left to their own devices. Suppose, for example, there is reason to believe that 90% of fully-informed participants in a particular sort of relationship would choose Rule 1 over Rule 2. If Rule 1 is chosen as the default rule, this will force only 10% of participants to choose a customized rule or put up with a rule they do not prefer. If, however, Rule 2 is the default rule, 90% of participants will either have to put up with the rule they do not prefer or go to the trouble and expense of selecting a customized rule to replace the default rule. In the circumstances, Rule 1 seems to be the more logical choice for the default rule.[7]

2. Default Investment Powers Under Section 5

[21] We have described section 5 of the *Trustee Act* as an example of the legal list approach to default trustee investment powers. Here we will briefly describe the nature of the list embodied in section 5 without going through the sixteen-clause list in detail.[8]

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[6] Different considerations will apply if the purpose of a legislative or judicial rule is to preempt the choice of participants on a particular matter. We are concerned here with relationships where it is assumed that participants should be able to choose their own ground rules.

[7] See Levy 1994 at 28.

[8] Section 5 of the *Trustee Act* is reproduced in Appendix A.

[22] The section 5 list is dominated by debt securities: not just any old debt securities, but securities of a type that would seem to entail little risk of default. In theory, some investment in equities is possible. In practice it would be very difficult for trustees to determine whether a particular share meets the criteria laid down by the Act.

[23] The investments authorized by section 5 can be divided into the following rough categories:

- debt instruments issued, or at least guaranteed in some fashion, by certain governments or bodies with taxing authority, or by certain international financial institutions;
- debt instruments of corporations that are incorporated in a Canadian jurisdiction and that meet strict criteria of financial stability;
- debt instruments of regulated financial institutions, such as banks and trust companies;
- loans secured by first mortgages on real property that meet certain criteria as to the value of the property relative to the amount of the loan;
- shares of corporations that are incorporated in a Canadian jurisdiction (preferred shares) or a Canadian or American jurisdiction (common shares) and that meet strict criteria regarding the payment of dividends;
- shares of the Alberta Energy Company.

[24] Section 6 of the Act contains further restrictions on the securities in which a trustee may invest. The restrictions are aimed primarily at preventing trustees from weighting the trust portfolio heavily towards corporate securities, even if the corporations in question meet the stringent financial stability tests of section 5. For example, no more than 15% of the trust's portfolio can be invested in common shares.[9]

3. Court-Approved Investments

[25] Section 7 of the *Trustee Act* authorizes the Court of Queen's Bench to give trustees broader investment powers than are given by section 5:

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[9] *Trustee Act*, s. 6(8). The trustee cannot make a purchase of common shares that would bring the aggregate market value of the trust's common shares above the 15% threshold, but the trustee is not required to divest itself of common shares merely because changes in market values bring the value of the trust's common shares above the threshold: *ibid.*, s. 6(9).

> In addition to the investments authorized by section 5 or by the trust instrument (except when that instrument expressly prohibits the investment), a trustee may invest funds in any other securities that the Court of Queen's Bench on application in any particular case approves as fit and proper, but nothing in this section relieves the trustee of his duty to take reasonable and proper care with respect to the investments so authorized.

This section provides trustees with a theoretical avenue for obtaining much broader investment powers than are provided by the trust instrument or section 5. But it is an avenue down which trustees rarely seem to travel in practice.

B. A Brief History of Default Trustee Investment Powers

1. Judicial Constraints on Trustee Investments

[26] Although the institution of the trust has its origins in feudal times, the issue of the appropriate range of trustee investments seems to go back to the early 1700s.[10] At that time the English courts of equity had not developed rules regarding trustee investments. In the early 1700s speculation in the shares of the South Sea Company led to what has become known as the"south sea bubble." When the bubble collapsed, it turned out that some trustees had invested trust funds in speculative stock that was now worthless, leaving many beneficiaries impoverished.[11] This unhappy experience led the courts of equity to require trustees to confine their investments to well-secured mortgage loans and government debt.[12]

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[10] Our account of the early history of trustee investments is based on Keeton 1971 at 45-50 and Waters 1984 at 766-68.

[11] Keeton 1971 at 47; Waters 1984 at 767.

[12] Keeton 1971 at 46-47; Waters 1984 at 767. The following passage from *Pocock v. Reddington* (1801), 31 E.R. 862 at 865, indicates that the restrictions on trustee investments were well settled by the beginning of the nineteenth century:

> The rule upon this subject is, that, when an executor or trustee, instead of executing the trust, as he ought, by laying out the property either in well secured real estates or upon Government securities, takes upon him to dispose of it in another manner, the *Cestuys que trust* [beneficiaries] may call him to an account . . .

It is interesting to observe that the rule was applied in this case even though the will that created the trust seemed to give the trustee broad scope for investing: "that the trustees should . . . increase and improve the residue of such monies by placing the same out at interest, as the trustees should see occasion:" *ibid.*, at 863. The trustee had sold safe securities and lent the proceeds to a firm that later became insolvent.

2. Statutory Lists of Authorized Trustee Investments

[27] Starting in the middle of the nineteenth century, legislatures began to cautiously expand the range of permitted trustee investments beyond those that had been sanctioned by the courts. A United Kingdom Act of 1859 allowed trustees to invest in the stock of a few specified companies, and later acts gradually added to the list of permitted trustee investments in the United Kingdom.[13]

[28] The default investment powers of trustees in the United Kingdom are currently determined by the *Trustee Investments Act 1961*, which is a version of the legal list approach. The basic structure of this Act was summarized in a 1982 report in the following terms:

> . . . its scheme is to divide permitted investments into two groups, the narrower-range and the wider-range investments. The former consist chiefly of gilt-edged and other fixed-interest securities such as National Savings Certificates, the latter chiefly of industrial equities. Some narrower-range and all wider-range investments may only be made after the trustees have taken advice . . . Trustees may invest the whole of the trust fund in the narrower-range, but their overriding duty to have regard to the need for diversification of investments will normally deter them from doing so. However, where they wish to invest in any wider-range securities they must divide the whole fund into two equal parts and they may then invest one but only one of those parts in the wider-range.[14]

[29] The report went on to observe that the majority of witnesses believed that the Act's provisions "were out of date and, where applicable, restricted sensible trust investment" and that "in the vast majority of cases the Act is either modified or wholly excluded in the trust instrument."[15] The report recommended that the scheme of the 1961 Act be abolished and replaced with one along the following lines:

> We think that investments should be divided into those which can be made without advice and those which can be made only with advice. We think that the former category should comprise those investments presently known as narrower-range securities and listed in Parts I and II of the 1961 Act. In addition, trustees should be empowered to invest in unit trusts and investment trusts [ie. mutual funds] . . . without the necessity of taking

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[13] Keeton 1971 at 48-62; Waters 1984 at 768-72.

[14] LRC 1982 at 15.

[15] *Ibid.* at 16.

> advice. The category of investments requiring advice should comprise any other investment quoted on the English stock exchange.[16]

Although the report's recommendations would have considerably widened trustee's investment powers, they would not have abandoned the legal list approach. The broader category of investments would have been limited to investments quoted on the English stock exchange.

[30] Until the last quarter of the twentieth century, Canadian trustee investment legislation followed the same general path as was followed by the UK. This path consisted of a succession of acts that gradually expanded the range of authorized trustee investments, while maintaining the fundamental concept of legislatively specified categories of authorized investments. Trustee investment legislation in Alberta well illustrates the process of incremental expansion of the range of permitted trustee investments.

[31] Alberta's original trustee investment legislation was inherited from a North-West Territories ordinance of 1903.[17] The ordinance permitted trustees to invest trust funds in (1) debt securities issued or guaranteed by the government of Canada or any province, (2) debentures of any municipality or school district in the Territories, and (3) loans secured by first mortgages.[18] Thus, the range of investments authorized by the ordinance was essentially the same as that which had long been permitted by courts of equity.

[32] Alberta's statutory trustee investment powers have been amended a number of times in the hundred years or so since the territorial ordinance of 1903.The first amendment was in 1917.[19] The amendment permitted trustees to deposit trust funds with or invest in debentures of mortgage loan companies that met certain criteria as to minimum capitalization, reserve funds and market value of their

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[16] *Ibid.* at 17.

[17] *The Trustee Ordinance*, O.N.W.T. 1903 c. 11, ss 3-7.

[18] *Ibid.* s. 3(1).

[19] S.A. 1917, c. 36.

shares.[20] Deposits or investments were permitted only in mortgage loan companies that had been approved for this purpose by the Lieutenant Governor in Council.[21]

[33] Between 1917 and 1966, the only change of any consequence in the investment powers of Alberta trustee occurred in 1953, when trustees were authorized to invest in debentures of any municipality of any other province of Canada.[22] In 1966 trustee investment powers assumed essentially the same form in which they exist today.[23] The 1966 amendments were based largely on a uniform act regarding trustee investments adopted in 1957 by the Uniform Law Conference of Canada ("ULCC").[24] The most significant departure of the Alberta provisions from the ULCC's act was with respect to common shares.

[34] In the process leading up to its adoption of the 1957 uniform act, the ULCC had considered giving trustees a limited power to invest in common shares, but the act as adopted contained no provision for investing in common shares.[25] When Alberta eventually adopted the uniform act in 1966, it followed the approach that some other provinces had taken,[26] which was to include a provision giving trustees a limited power to invest in common shares. The provision, as it reads in section 5(k) of the current *Trustee Act*, is as follows:

> fully paid common shares of a corporation incorporated in Canada or the United States of America that during a period of 5 years that ended less than one year before the date of investment has either
>
> (i) paid a dividend in each of those years on its common shares, or
>
> (ii) had earnings in each of those years available for the payment of a dividend on its common shares,
>
> of at least 4% of the average value at which the shares were carried in the capital stock account of the corporation during the year in which the dividend

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[20] *Ibid.* s. 1.

[21] *Ibid.* s. 3. The basic idea of the 1917 amendment is preserved in the current Act's concept of an approved corporation: *Trustee Act*, ss 2(a), 4, 5(i), 8(c).

[22] S.A. 1953 c. 116, s. 2.

[23] S.A. 1966, c. 104.

[24] ULCC 1957 at 24, 82-86.

[25] Waters 1984 at 773.

[26] *Ibid.*

> was paid or in which the corporation had earnings available for the payment of dividends, as the case may be.

A trust may purchase no more than 30% of the "total issue of shares" (common or preferred) of any corporation.[27] A more significant restriction for everyday investment purposes has already been noted. A trustee cannot make a purchase of common shares that would bring the aggregate market value of the common shares held by the trust to more than 15% of the total market value of the trust fund.[28]

[35] Since 1966 there have been only minor additions to the list of permitted trustee investments. For example, the provision allowing trustees to invest in shares of the Alberta Energy Company was added in 1974,[29] as was a provision allowing for investment in Canadian or US dollar securities issued or guaranteed by Inter-American Development Bank or by Asian Development Bank.[30]

3. The Prudent Man Approach

[36] We have seen that statutory legal lists of authorized trustee investments actually originated as extensions of the narrow categories of investments endorsed by English courts of equity: government debt and well-secured mortgage loans. In some American states, on the other hand, the courts took a different view of the appropriate approach to trustee investment.

[37] In 1830 a Massachusetts court pronounced what has come to be regarded as the classic expression of the "prudent man" rule for trustee investment.[31] In response to the contention of beneficiaries that trustees had improperly invested trust funds in unsafe insurance and manufacturing stocks, the court stated a trustee's duty in the following terms:

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[27] *Trustee Act*, s. 6(7).

[28] *Ibid.* s. 5(8).

[29] This company-specific expansion of trustee investment powers was effected by the *Alberta Energy Company Act*, S.A. 1974, c. 6, s. 6(4). The company was originally conceived as a vehicle by which the Alberta government and ordinary citizens could invest in the energy industry. However, in 1993 the government sold its shares in the company and repealed the *Alberta Energy Company Act*. The company still exists, but the apparent policy reasons for affording its shares special status as authorized trustee investments do not.

[30] S.A. 1974, c. 14, s. 7(2).

[31] *Harvard College v. Amory* 26 Mass. (9 Pick.) 446 (1830).

> [The trustee] shall conduct himself faithfully and exercise a sound discretion. He is to observe how men of prudence, discretion and intelligence manage their own affairs, not in regard to speculation, but in regard to the permanent disposition of their funds, considering the probable income, as well as the probable safety of the capital to be invested.[32]

The Massachusetts court, it may be observed, was no less concerned with the safety of capital than were the English courts that had restricted trustees to investment in government debt and mortgages. The Massachusetts court, however, chose to lay down a general standard for trustee investment practice, rather than prescribing a list of "safe" trustee investments.

[38] The Massachusetts prudent man rule was not immediately or even quickly adopted by most states. For many years after 1830, many states followed an approach closely resembling the legal list approach favoured in England and Canada.[33] It was not until the middle of the twentieth century that the prudent man test became the dominant approach to default trustee investment powers in the United States.[34]

[39] We have mentioned that in 1957 the ULCC adopted uniform trustee investment legislation that was essentially an expanded version of the legal list that had long been in effect in all provinces. The 1957 act was not widely adopted by the provinces, and in the mid-1960s the ULCC decided to revisit the issue of trustee investments.[35] A report submitted to the 1966 ULCC conference by its Quebec Commissioners described the basic issue in the following terms:

> The principal objective of trustee investments is to conserve the assets under administration for the benefit of the ultimate beneficiaries of the capital and to produce a reasonable income for the income beneficiaries. The variety of statutory provisions in Canada, the United States, and the United Kingdom discloses disagreement as to how these objectives can be best attained.
>
> The view taken by some jurisdictions is that the principal aim of the law must be to protect the funds under administration from imprudent investing on the part of the trustee. The result is a restricted list of permissible

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[32] *Ibid.* at 461, quoted in Friedman 1964 at 553.

[33] Friedman 1964 at 554-572.

[34] *Ibid.* at 571. See also Quebec Commissioners 1966 at 110, where it is noted that in 1939 only nine American states followed the prudent man rule, but that by 1960 31 states followed the prudent man rule and a further ten had adopted a limited or modified version of the rule.

[35] Waters 1984 at 774.

> investments commonly known as the "legal list", of which the principal characteristic is "safety" in the sense that such investments are not supposed to be likely to depreciate as to their face values. Typical examples are government bonds and first mortgages (hypothecs).
>
> Such guaranteeing of face values by the substitution of the state's view of what is a prudent investment for that of the individual trustee through the enactment of a legal list does not, however, result in the preservation of the real value of the funds. Indeed, the latter is certain to decline with the passage of time because of a number of factors.[36]

[40] The Quebec Commissioners went on to recommend "that a new Uniform Trustee Investment Act adopt the Prudent Man Rule,"[37] and this recommendation was adopted.[38] Reaching agreement on the precise legislative expression of the prudent man rule proved considerably more difficult than agreeing on the concept,[39] so it was not until 1970 that the ULCC adopted the following statutory expression of the prudent man rule:

> Unless a trustee is otherwise authorized or directed by an express provision of the law or of the will or other instrument creating the trust or defining his powers and duties, he may invest trust money in any kind of property, real, personal or mixed, but in so doing, he shall exercise the judgment and care that a man of prudence, discretion and intelligence would exercise as a trustee of the property of others.[40]

[41] New Brunswick and the Northwest Territories enacted the ULCC's prudent investor legislation very shortly after the ULCC adopted it, and the Yukon Territory did likewise in 1980.[41] Although other provinces have subsequently abandoned the legal list approach, reference to these subsequent developments will be deferred until we have described the refinement of the prudent man approach represented by the prudent investor approach.

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[36] Quebec Commissioners 1966 at 106.

[37] *Ibid.* at 111.

[38] ULCC 1966 at 23.

[39] Quebec Commissioners 1970 at 115 reports that drafts submitted at the 1967, 1968 and 1969 conferences all failed to achieve the necessary degree of consensus to be adopted as uniform acts.

[40] ULCC 1970, Appendix E at 117. This is the first section of a three-section uniform act. The second section deals with deposit of trust monies pending investment and the third provides that the first two sections apply to trusts arising before or after the coming into force of the amending act.

[41] Waters 1984 at 775.

4. The Prudent Investor Approach

a. Controlling Portfolio Risk Through Diversification

[42] In our consultation memorandum we said that the prudent investor rule is a legal application of modern portfolio theory ("MPT").[42] MPT can be thought of as a general rubric for certain theoretical approaches to acknowledging and applying the old aphorism, "don't put all your eggs in one basket:"

> Modern Portfolio Theory (MPT) developed from the work done by Harry Markowitz in 1952 on Portfolio Selection. In essence, it is based on the single observation that the proper task of the investment manager is not simply to maximize expected return, but to do so at an acceptable level of risk. If this were not so, portfolios would consist solely of managers' favorite stocks, instead of combining different stocks which, although all not equally attractive when considered individually, together offer the maximum expected return for a given level of risk.
>
> This observation itself was not new. The originality of Markowitz's contribution lay in showing how investment risk could be measured and, hence, how mathematics could be used to select the best possible portfolio from all the different combinations of a chosen list of stocks.
>
> There have been many refinements of the theory since. What is now commonly referred to as MPT is no longer a single theory, but several different theories or models, together with their applications.[43]

For our purposes, the most important point to be drawn from this passage is that the prudent investor rule is based on a rather simple concept, that risk can be controlled by effective diversification. Although the basic concept can be elaborated and implemented in theories of dizzying complexity, the rationale for the prudent investor rule owes more to the simple concept of controlling risk through diversification than to the nuances of any particular theory or model that falls under the rubric of MPT.

[43] Although we have no intention of getting into the details of MPT, it is worth emphasizing a fundamental premise that underlies any version of the theory. It is that the effect of a particular asset on the overall risk-profile of a portfolio cannot be determined simply by determining whether that asset, viewed on its own, is "high-risk" or not. The effect of the asset on the overall risk associated with the portfolio depends on how the risk factors associated with that asset interact with risk factors associated with other assets. Adding an asset with highly volatile returns to a portfolio may actually decrease the overall risk associated with the

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[42] ALRI 1999 at para. 11.

[43] MacQueen 1986 at 52.

portfolio if factors that tend to move that asset's return in one direction tend to move the returns for other components of the portfolio in the other direction.[44]

[44] The objective of the hypothetical prudent investor in selecting an investment portfolio is not to maximize expected return nor is it to minimize risk. The objective is to achieve an optimal relationship between expected return and risk. Having determined a target rate of return, the prudent investor will aim for a portfolio with the lowest level of risk that is consistent with achieving the target rate of return. Conversely, a prudent investor who has first determined an acceptable level of risk will aim to assemble a portfolio with the highest expected return consistent with this level of risk.

[45] The relative weight which any given prudent investor puts on reducing risk versus increasing expected returns will depend largely on the circumstances of the investor. For example, a sixty year old investor (investing on their own behalf) would typically be expected to put a greater relative emphasis on reducing overall portfolio risk than would a thirty year old investor. The sixty year old investor has reason to be more risk averse than the thirty year old investor. The potentially adverse consequences of short-term volatility in an investment portfolio will fall more heavily on the typical sixty year-old than on the typical thirty-year old. However, every prudent investor will assign some weight to risk reduction and some weight to expected returns when determining their overall investment objectives.

b. The Trustee as Prudent Investor

[46] There is an obvious inconsistency between the prudent investor approach and the legal list approach. The inconsistency is described in a recent report of the British Columbia Law Institute ("BCLI"):

> These rules [the legal list approach] tend to discourage trustees from applying investment strategies that make use of modern portfolio theory, which is based on reduction of overall risk to the portfolio as a whole by acquiring a wide range of investments. Those carrying higher return, and correspondingly greater risk, are balanced in a well-diversified fund by those

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[44] See Levy 1994 at 19-20, where there is an example of how the addition of a volatile asset (a mutual fund investing primarily in precious and strategic metals stocks) can both lower the riskiness and increase the expected return of a portfolio.

> carrying lower risk.[45] Portfolio theory recognizes the fact that concentration in a few securities means losses in those categories will magnify the proportional loss to the fund. It also recognizes that the probability of loss in a great number of categories at the same time is much smaller than the chance of loss in one category. In other words, modern portfolio theory favours *diversification*.[46]

What is less obvious is that the prudent man rule, as it had been developed by American courts over the years, was also inconsistent with MPT.[47]

[47] The prudent man rule as it developed from its origins in 1830 Massachusetts became fettered with constraints that led to its sometimes being referred to as the *constrained prudent man* rule. The nature of the constraints are hinted at by the actual wording of the famous passage in *Harvard College v. Amory*: "how men of prudence, discretion and intelligence manage their own affairs, *not in regard to speculation, but in regard to the permanent disposition of their funds*."

[48] In one sense, that trustees should refrain from speculating with trust property is implicit in the very reference to "men of prudence." By definition, it may be argued, men of prudence do not speculate with their own property, so a trustee who observes the prudent man standard will not speculate with trust property.

[49] The problem, from the perspective of trustees who were attempting to invest prudently with a view to obtaining a reasonable view, was that some American courts took an expansive view of what constituted speculative investment practices:

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[45] It is worth reiterating that reduction of risk is achieved not just by balancing high expected-return, high risk assets with low expected-return, low risk assets. Suppose that assets L1 and L2 are both relatively low risk investments, while assets H1 and H2 are relatively high risk investments. The return on asset L1 is highly correlated with the return on asset L2, but the return on asset H1 is negatively correlated with the return on asset H2. Because of the high correlation between the returns on L1 and L2 and the negative correlation between the returns on H1 and H2, the overall riskiness of a portfolio consisting of the two individually high-risk assets could be lower than the riskiness of a portfolio comprised of the two low-risk assets. MLRC 1982 at 25-27 gives a concrete example of where two simultaneous transactions that are both high risk when viewed in isolation are actually low-risk when viewed together. The example involves selling a company's shares short and simultaneous purchasing on 50% margin a convertible debenture issued by the same company.

[46] BCLI 1999 at 6.

[47] We emphasize that we are using MPT in its general sense as a rubric for theories emphasizing the portfolio approach to controlling risk.

> Speculation, as it is prohibited in the Prudent Man Rule, is a much more inclusive category than the term as it is used by investors in general. "Speculation," as the term is used in the Prudent Man Rule, has been interpreted to include every investment made with the motive of seeking a gain in the market value of the investment. This very old definition of speculation for Prudent Man Rule purposes has not been repudiated. It is this broad definition of speculation that makes the Prudent Man Rule prohibition of speculation an unreasonably restrictive provision. The duty of prudent behavior alone would prohibit the high risk investments that the word "speculation" calls to mind in general usage.[48]

[50] Another way of describing the problem that many observers saw with some courts' approach to speculative investments is that it assessed risk on an investment-by-investment basis. These observers argued that the appropriate approach to evaluating the prudence of the trustee's investment conduct was to consider the whole trust portfolio and to evaluate particular investment decisions within the context of the trustee's overall investment strategy. On this view, you cannot say whether an investment in a particular asset is unduly risky or not without first considering its context.[49] The contrast between the two approaches to assessing prudence is captured by the following passage:

> Under modern portfolio theory, a volatile investment that varies in price, if its price movement is not correlated with other assets in the portfolio, may add to portfolio return without increasing portfolio risk. By contrast, under the constrained prudent man rule, volatile investments are forbidden, even if it can be shown that they reduce portfolio risk. The prudent man rule requires diversification, but only permits investment in non-speculative assets. For example, passive investment in an index fund would be prohibited because it would expose the beneficiary to the potentially speculative aspects of some stocks within the index.[50]

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[48] Cooper 1982 at 70.

[49] This requires a caveat that it must be possible to view the asset in question as a component of a rational investment strategy. Purchasing lottery tickets, for example, could not be so viewed. It is not just that purchasing lottery tickets is a risky investment strategy. Indeed, it would be possible to build a diversified portfolio of lottery tickets that would be low-risk, in the sense that the variance of the probability weighted distribution of possible returns would be low. The problem is that the expected return–the probability weighted average of all possible returns minus the amount invested–would be negative. A rational investment strategy might be quite risky, but it will at least have positive expected returns.

[50] Levy 1994 at 8.

i. United States

[51] Trustees who were subject to the constrained prudent man rule found that it was constraining them to accept lower returns than they could achieve by following conventional prudent investment practices. Eventually, this led to reform of the law on a national scale. In 1974 the federal *Employee Retirement Income Security Act* moved some way towards the prudent investor standard from the constrained prudent man rule.[51] In 1990 the American Law Institute adopted the Restatement (Third) of the Law of Trusts. The Restatement, an unofficial but highly authoritative statement of the law of trusts, unequivocally adopted the prudent investor rule.[52] Then in 1996 the National Conference of Commissioners on Uniform State Laws ("NCCUSL") adopted the Uniform Prudent Investor Act ("UPIA"), which is intended to give legislative effect to the prudent investor rule. To date, over thirty states have adopted the UPIA,[53] and other states have enacted their own version of the prudent investor rule.

ii. Other Canadian Provinces

[52] Manitoba adopted a variation of the 1970 uniform trustee investment provisions in 1983. It did so in accordance with recommendations of the Manitoba Law Reform Commission ("MLRC").[54] As mentioned earlier, the main weakness of the prudent man rule from the perspective of MPT is that the former does not expressly incorporate the latter's tenet that risk is to be assessed on a portfolio-wide basis, rather than on an investment-by-investment basis. And the American experience with the prudent man rule was that courts tended to assess prudence on an investment-by-investment basis, rather than on a portfolio-wide basis. In its report the MLRC considered this weakness of the prudent man test and made the following recommendation to address it:

> . . . an additional section should be enacted stating that if a trustee is sued for imprudence, it shall be a defence for that trustee to show that while a particular investment viewed in isolation may have been speculative or

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[51] *Ibid.* at 3-4.

[52] *Ibid.* at 6.

[53] The NCCUSL web site lists 32 states and the District of Columbia as having adopted the UPIA: http://www.nccusl.org/ (Last updated: August 24, 1999).

[54] MLRC 1982.

> imprudent, the trustee nonetheless followed a prudent investment policy and that this total policy was not speculative and not imprudent.[55]

This recommendation was implemented by what is now section 79 of the Manitoba *Trustee Act*.

[53] In its 1994-95 session, Nova Scotia's Legislature amended its *Trustee Act* to replace the legal list with a test that expressly measures prudence in the context of the overall portfolio of investments:

> Subject to Sections 4 and 5, a trustee may, for the sound and efficient administration of a trust, establish and adhere to investment policies, standards and procedures that a reasonable and prudent person would apply in respect of a portfolio of investments to avoid undue risk of loss and obtain a reasonable return.[56]

Section 4 provides for regulations that could authorize or prohibit investment in particular types of asset, but no such regulations have been made to date. Section 5 implements the principle that statutory trustee investment powers are merely *default* powers, which give way to a contrary intention expressed in the trust instrument.

[54] In 1997 the ULCC adopted the Uniform Trustee Investment Act ("UTIA") and recommended its adoption by all provinces and territories. The UTIA is based quite closely on the American UPIA. As such, it goes beyond the 1970 uniform investment provisions by expressly incorporating MPT's tenet that the prudence of any given investment must be evaluated in the context of the trustee's overall investment strategy. The UTIA has been adopted by Prince Edward Island (1997)[57] and, with certain variations, by Saskatchewan (1998)[58] and Ontario (1998).[59] The BCLI has recently issued a report that recommends that British Columbia adopt the prudent investor rule, without expressly recommending adoption of the UTIA.[60] And although Manitoba's Trustee Act has since 1983 incorporated certain aspects

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[55] *Ibid.* at 27.

[56] *Trustee Act*, R.S.N.S. c. 479, s. 3, as am. by S.N.S. 1994-95, c. 19, s. 1.

[57] *Trustee Act*, R.S.P.E.I. 1988, c. T-8, ss 2-3.5, as am. by S.P.E.I. 1997, c. 51.

[58] *The Trustee Act*, R.S.S. 1978, c. T-23, ss 3-3.3, 44, 57.1, 57.2 , as am. by S.S. 1998 c. 40.

[59] *Trustee Act* R.S.O. 1990, c. T.23, s. 27, as am. by S.O. 1998, c. 18, Sched. B, s. 16: in force as of July 1 1999.

[60] BCLI 1999.

of portfolio theory, the MLRC has recently issued a report that recommends incorporation of other aspects that are missing from the current statute.[61]

iii. New Zealand and Australia

[55] Up until about 10 years ago, New Zealand and all the Australian states followed their own variations of the legal list approach. In 1988 New Zealand replaced the legal list approach with the prudent investor rule.[62] The legal list approach survived only a short while longer in Australia. In 1995 South Australia, Victoria and the Northern Territory adopted the prudent investor rule[63], and the other states have since done so as well.[64]

iv. The United Kingdom

[56] The legal list approach survives in the United Kingdom in the form of the *Trustee Investments Act 1961*, to which we referred earlier. However, its days appear to be numbered.

[57] We have mentioned that a 1982 report recommended significant changes to the 1961 UK act.[65] Although the recommendations were not implemented, the survival of the 1961 act seems to owe more to legislative inertia than to enthusiasm for its approach to trustee investment. In 1996 the Treasury Department issued a consultation document that proposed that the *Trustee Investments Act 1961* be repealed and that trustees "have all the powers of an absolute owner in relation to the investment of trust assets."[66] In July of 1999 the two UK law reform commissions–the Law Commission and the Scottish Law Commission–issued a joint report that notes that "an overwhelming majority of those who responded to consultation were firmly in favour" of the Treasury's 1996 proposals, as well as to

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[61] MLRC 1999.

[62] *Trustee Amendment Act 1988* (1988, No. 119), s. 3.

[63] McDermott 1996 at 801.

[64] *Trustee Act 1925* (NSW), as am.; *Trustee Act* (NT) as am.; *Trustee Act 1936* (SA), as am.; *Trustee Act 1958* (VIC), as am.; *Trustees Act 1962* (WA), as am.; *Trustee Act 1898* (TAS), as am.; *Trusts Act 1973* (QLD) (as amended by *Trusts (Investments) Amendment Act 1999*–unproclaimed as of December 1999).

[65] LRC 1982. See para. 29, above.

[66] As summarized in LC & SLC 1999 at 2 (para. 1.4).

similar proposals in a consultation paper published by the Law Commission in 1997.[67] Not surprisingly, the report reiterates the earlier recommendations:

> . . . the Trustee Investments Act 1961 should be repealed and replaced with a new statutory provision giving trustees power to make an investment of any kind as if they were absolutely (or beneficially) entitled to the assets of the trust.[68]

v. Alberta

[58] Although Alberta retains the legal list approach in the *Trustee Act*, the prudent investor approach is acknowledged in some Alberta legislation. Section 94(1) of the *Insurance Act*,[69] for example, requires insurance companies to invest their own funds (as opposed to funds held as trustees or in some other fiduciary capacity) in accordance with "prudent investment standards." Section 94(2) defines prudent investment standards in the following terms:

> For the purposes of this Act, prudent investment standards are those which, in the overall context of an investment portfolio, a reasonable and prudent person would apply to investments made on behalf of another person with whom there exists a fiduciary relationship to make such investments without undue risk of loss or impairment and with a reasonable expectation of fair return or appreciation.

Other legislation defines prudent investor standards in the same way.[70]

[59] The actual and proposed reforms in other Canadian provinces, the United States, New Zealand, Australia and the United Kingdom, as well as the recognition of the prudent investor approach in some Alberta statutes, make one thing is clear. It would not at this time be particularly innovative or daring for Alberta to abandon the legal list approach in favour of the prudent investor rule as the default rule for trustee investments.

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[67] *Ibid.* at 6 (para. 1.18).

[68] *Ibid.* at 9-10 (para. 1.3).

[69] R.S.A. 1980, c. I-5.

[70] *Credit Union Act*, S.A. 1989 c. C-31.1, s. 100; *Glenbow-Alberta Institute Act*, R.S.A. 1980 c. G-5, s. 17.2, as am. by S.A. 1996, c. 21, s. 16; *Loan and Trust Corporations Act*, S.A. 1991, c. L-26.5, s. 196. The *Regional Health Authorities Regulation*, Alta. Reg. 15/95, s. 2.4 takes the same approach as these statutes. However, the Regulation goes on to prescribe in some detail the procedure that regional health authorities must follow in making investment decisions, and restricts or prohibits particular types of transactions. Section 2.4(6)-(9) places restrictions on derivatives trading, while section 2.4(10) prohibits "short selling of securities."

CHAPTER 3. ANALYSIS AND RECOMMENDATIONS

A. Legal Lists, Prudent Investors and Risk

[60] The mere fact that the legal list approach has been abandoned in favour of the prudent investor approach in jurisdiction after jurisdiction is not decisive evidence that the latter is a better approach to default trustee investment powers than the former. Certainly, the tide of prudent investor legislation is evidence of something. But a defender of the legal list approach might argue that it is better evidence of the power of effective lobbying or legislative bandwagon-jumping than of the objective superiority of the prudent investor approach. Therefore, we propose to spend a little time considering whether an optimized version of the legal list approach could reasonably be expected to achieve its intended purpose or purposes.

1. What is to be Accomplished

[61] Supporters of the legal list approach and supporters of the prudent investor approach would probably agree with the following statement about the objectives that a trustee should generally pursue in investing trust property. First, the trustee should invest in a manner that will not expose the trust to undue risk. Second, the trustee should invest trust funds in a manner that can be expected to obtain a reasonable return. From here, however, proponents of the two approaches are likely to part company. The legal list approach rests on a presumption that the legislature can and should prevent trustees from exposing trusts to undue risk by restricting them to investing in "safe" assets, or at least severely limiting their ability to invest in "risky" assets.

[62] The prudent investor approach proceeds from the premise that there are risks and potential rewards associated with all investments. On this view, any attempt to prevent trustees from assuming undue risk that depends on a legislative categorization of different types of assets as inherently low-risk or high-risk is doomed to failure. It is so doomed because the legislative categorization will be based on a simplistic, one-dimensional definition of risk. Ultimately, the only thing that can ensure that a trustee's investment policy strikes an appropriate balance between risk and expected returns is the prudence and sagacity of the trustee and

the trustee's advisers, applied in the context of the objectives and circumstances of the particular trust. On this view, the role of trustee investment legislation is to remind trustees of their duty to be prudent and sagacious, and to allow trustees to develop and apply investment strategies that are appropriate to the circumstances and requirements of the particular trust.

2. Different Types of Risk

[63] Suppose that an investor buys at par a 20-year bond with a coupon rate[71] of 6.5%.. What risk does the investor assume in purchasing this bond? A better way to phrase this question might be to ask what *types* of risk the investor assumes. To a certain extent, the answer depends on characteristics of the bond and its issuer. However, to a large extent, the types of risk assumed depend on the investor's intentions in purchasing the bond.

[64] One sort of risk that might be associated with the bond–the sort of risk that has long mesmerized drafters of legal lists–is the risk of default: the possibility that the issuer will not be able to honour its obligations under the bond. In evaluating investment options, it is generally assumed that certain debt instruments–those issued by the Government of Canada or certain other governments–have a zero probability of default.[72] Other debt instruments are assumed to have a non-zero probability of default; the spread in the yields between a Government of Canada bond and a bond issued by a large corporation is largely a "risk-premium" that reflects financial markets' perception of the risk that the corporate issuer will default on its obligation.

[65] Leaving default risk to one side, inflation, or financial market participants' expectations about future inflation, represents a significant source of risk. Suppose the investor has no intention of disposing of the bond prior to maturity. In this case, the investor knows with certainty the amount and timing of payments that will be received on the bond. But the real value of the future payments of interest and principal depends on the future rate of inflation, which obviously cannot be

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[71] The coupon rate is simply the annual interest payment promised by the bond divided by the bond's face value.

[72] Of course, it is always possible to imagine circumstances in which the Canadian government either could not or would not honour its debt obligations, but those circumstances are regarded as sufficiently remote to be disregarded for investment planning purposes.

known when the bond is purchased. Thus, the investor incurs risk with respect to the real value of the future payments, even though their amount and timing is known with certainty.

[66] Suppose there is a good chance that the bond will not be held to its maturity date. In this case, it is highly unlikely that the price for which the investor sells the bond will be its par value. Depending on whether interest rates have gone up or down between the purchase and sale dates, the price of the bond will have gone down or up. So, even in terms of nominal dollars, the investor incurs a risk that the bond will be worth less when it is sold than when it was purchased.

[67] By no means have we mentioned every form of risk that could be associated with investment in a bond. However, we have said enough to illustrate that when evaluating the risk associated with investment in a particular asset or type of asset, one must consider different sources of risk. An asset that is virtually risk-free in one sense (e.g. in terms of the possibility of default), may be highly risky in some other sense (e.g. in terms of its real, inflation-adjusted value twenty years down the road).

3. The Problem with Legal Lists

[68] Suppose that we were to set out to design an optimal legal list. The first thing we would need to do is to decide exactly what we want our list to achieve. The objectives stated above–preserving the capital and generating a reasonable return–are all well and good, but we need something a little more specific for the purpose of coming up with a legal list.

a. Designing the List to Preserve the Nominal Value of the Capital

[69] One option is to design the list so as to achieve the following objective: to ensure, insofar as it is possible to do so, that the face value of the trust's capital is preserved, and that the trust investments earn whatever income is possible given this overriding objective. One thing that can be said for this objective is that it is achievable. We could in fact create a legal list that will virtually ensure that trustees who adhere to the list will preserve the face value of the capital. We could, for example, restrict trustees to investing in short term government debt

obligations and government bonds with maturities shorter than the expected duration of the trust.[73]

[70] The trouble is that while the objective is achievable, it is not particularly sensible. The obvious problem with an objective of ensuring that trustee investments preserve the nominal value of the capital at all costs is that an investment policy aimed at preserving the nominal value of the capital is also very likely to ensure the erosion of its real value. It may also ensure the erosion of the real value of future income from the investments. The culprit, of course, is inflation, abetted by taxation.

[71] Taxation aside, a trustee who invested exclusively in the most conservative assets should in theory be able to preserve the real value of the trust capital while paying a modest income to an income beneficiary of the trust. Suppose, for example, that a trustee is to pay the income of the trust to L for the duration of L's life and then pay the capital to R, and that the trustee is directed to reinvest enough of the trust's income to maintain the real value of the capital. The trustee could follow a simple investment policy of buying and rolling over 3-month treasury bills. At the end of each year the trustee could determine the amount by which the return on the T-bills exceeded inflation and pay the difference to the income beneficiary.[74]

[72] In reality, even in years where the pre-tax return on T-bills handily exceeds the rate of inflation, taxes would erase most or all of the margin.[75] At best, the after-tax, after-inflation income available for distribution to the income beneficiary would be a tiny fraction of the trust capital. At worst (particularly in high-inflation periods), no after-tax income would be available for distribution to the income

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[73] Although the market value of long term government bonds could vary widely over their term, it is certain (assuming that there is no default risk) that the face value of the bond will be paid at the end of the term. Therefore, if the trustee intends to hold the bond to maturity, fluctuations in the bond's market value during its term do not affect the point that the trustee knows with certainly exactly what return (in nominal dollars, at least) it will achieve on its investment.

[74] In some periods the yield on 3-month T-bills might not exceed the inflation rate. But over an extended period the yield on T-bills or other money market instruments will in practice exceed the inflation rate.

[75] This assumes, of course, that the particular trust or its beneficiaries are not tax-exempt.

beneficiary, and the real value of the trust capital would decline even though all of the after-tax income is reinvested in T-bills.

[73] It is conceivable that under very favourable inflation and tax conditions, a T-bills-only investment policy would allow a trustee both to preserve the real value of the trust capital and pay a modest income to an income beneficiary. It is a virtual certainty, however, that over any extended period, our hypothetical "preserve the face value of the trust capital at all costs" legal list would condemn trust beneficiaries to receiving substantially lower returns than could be achieved by a prudent trustee who can select from a broader range of investments.

b. A Legal List with Broader Objectives

[74] In the preceding section we said that it would not be too difficult to design a legal list that will ensure (insofar as trustees adhere to it) that the nominal value of the trust capital is preserved. However, pursuing such a single-minded objective is not particularly sensible. It preserves the nominal value of the capital at the expense of forcing prudent trustees to forego opportunities to earn substantially higher returns without taking on substantially more risk than is involved in the "ultra-safe" approach.

[75] Suppose that we try to design a legal list with the following objectives in mind: (1) preventing trustees from exposing the trust assets to undue risk; (2) providing trustees with a sufficiently broad range of permitted investments to allow them to obtain reasonable returns. Undoubtedly, everyone would agree that these are worthy, if somewhat vague, objectives. The problem is that any list that is broad enough to achieve the second objective will be too broad to ensure that a trustee who invests only in assets mentioned in the list will not expose the trust capital to undue risk. Once the list is broad enough to give trustees the flexibility necessarily to obtain reasonable returns, the only thing that can prevent a trustee from exposing the trust to excessive risk is the trustee's own prudence. Put shortly, if you are going to give all trustees the tools necessary to do their job, you need to put some reliance in trustees' ability to use the tools effectively and prudently.

[76] The provisions of section 5 of the *Trustee Act* can be used to illustrate the proposition that if the legal list is broad enough to allow prudent trustees to earn a

decent return, it almost certainly will be broad enough to allow imprudent trustees to put the trust's assets at undue risk.

[77] There is no general requirement in section 5 for trustees to diversify the trust's holding. There are requirements that prevent trustees from investing more than 35% of the trusts assets (measured by market value) in any combination of debt instruments (e.g. bonds and debentures) and preferred shares of Canadian corporations and approved corporations. Nor may a trustee invest more than 15% of the trust's assets in common shares. But these requirements do not effectively prevent imprudent trustees from incurring undue risk from a failure to diversify within the range of permitted investments. It is not difficult to think of examples of how a trustee could expose a trust to unnecessary risk–whether of outright default, depreciation of market value, or erosion of real value–by placing all or too many of their investment eggs in any one of the baskets represented in the section 5 list. The following paragraphs give a few examples.

[78] Suppose that a trustee of a trust with a likely duration of 5 years or so and assets of $100,000 decides to invest the whole amount in a marketable Government of Canada 20-year bond,[76] and is able to purchase such a bond at a price of 100 (i.e. 100% of par value).[77] There is presumed to be no appreciable risk that the Government of Canada will default on its obligations under this bond. There is, however, a significant risk that the market value of the bond when the trustee must sell it will be less (in nominal dollars) than it was when the trustee purchased it.[78]

[79] Another possibility is that a trustee invests the entire trust fund of, say, $500,000 in guaranteed investment certificates ("GIC"s) of a single trust

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[76] Notice that the term of the bond substantially exceeds the expected duration of the trust, at which time it is presumed the trustee will have to sell the bond.

[77] This sort of investment comes under s. 5(a) of the *Trustee Act*. There is no express restriction on the proportion of the trust's funds that can be invested in government bonds generally or in any particular bond issue.

[78] Of course, the bond price might be higher at maturity, but we are concerned here with the downside risk.

company[79] or certificates of deposit ("CDs") of a bank.[80] Nothing in the *Trustee Act* expressly prevents a trustee from taking this course of action. However, as the experience of the 1980s amply confirms, it is not unheard of for trust companies or banks to fail. The CDs or GICs would be insured by the Canada Deposit Insurance Corporation up to $60,000 per beneficiary,[81] but the balance of the investment would be exposed to the risk of default. Even though the risk of default on the GICs or CDs is presumably quite small, it is a risk that could easily be eliminated through diversification.[82]

[80] For our final example of how an imprudent trustee investing within the confines of section 5 of the *Trustee Act* could easily expose the trust to inordinate risk, we refer again to section 5(l), which authorizes investment in shares of the Alberta Energy Company ("AEC"). The special dispensation given to the shares of this company calls to mind an observation made of legal lists in the United States:

> Once enacted, the statutory legal lists tended to become patchworks. Investments were added for a number of reasons, sometimes simply because the legislature wanted to encourage investment in specific issues of securities.[83]

As noted earlier, although the Alberta government was originally the principal shareholder of AEC, the government sold all its shares several years ago. AEC is now in all respects an ordinary company. However, section 6(8) of the *Trustee Act*, which prevents trustees from investing more than 15% of the trust's assets in common shares, does not in terms apply to investment in shares of AEC. Therefore, so far as the express wording of the *Trustee Act* is concerned, a trustee could invest 100% of the trust's assets in AEC shares. Although shares of AEC could certainly constitute part of the portfolio of a prudent investor, a trustee who invested all or the bulk of a trust's assets in the shares of any one company would generally be exposing the trust to unnecessary risk.

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[79] *Trustee Act*, s. 5(g).

[80] *Ibid.*, s. 5(m).

[81] Information regarding deposit insurance coverage is available from the CDIC website: http://www.cdic.ca (accessed: December 15, 1999).

[82] The fact that the CDIC insures deposits up to $60,000 on an institution-by-institution basis gives the trustee an opportunity to completely diversify away the risk of default by investing in GICs and CDs of several financial institutions.

[83] Friedman 1964 at 568.

c. *Legal Lists as Guidance for Trustees*

[81] It is sometimes argued that the legal list approach is a means by which the legislature may provide investment *guidance* to unsophisticated trustees. In 1995 the Law Reform Commission of Saskatchewan ("LRCS") issued a consultation paper that rejected the "constrained prudent man" approach and argued for a refurbished version of the legal list approach.[84] The paper argued that the UK *Trustee Investment Act 1961*–

> ...embodies a more satisfactory policy in regard to trustee's investment than the prudent man rule. It provides guidance to trustees rather than merely enacting a criterion for judging their performance.[85]

[82] The paper acknowledged that Saskatchewan's then current version of the legal list approach was unsatisfactory but also considered that the "prudent man" approach was subject to serious criticism. In particular, the Commission thought that a vague statutory requirement to invest prudently could either lead Canadian courts to take the same restrictive approach as American courts have taken over the years in applying the prudent man test or leave unsophisticated trustees with no guidance as to appropriate investment strategies:

> If the prudent man rule is widely adopted in Canada, and content is given to it by referring to American precedent, very little will have been achieved [by way of allowing trustees to invest in accordance with MPT]. If, on the other hand, our courts do not turn to the American experience, we will be left with a virtual *tabula rasa* [blank slate]. In the worst case, the result would be *de facto* abandonment of any serious effort to provide guidance to trustees. Our courts might, of course, fill the void by evolving an appropriate interpretation of the rule that differs from the American model. In any event, adopting the prudent man rule would be less an exercise of law reform than a mechanism to pass the ball to the judiciary. Such a course of action could be justified only if no viable alternative exists.[86]

The LRCS paper goes on to recommend a legal list approach based on that recommended by the Law Reform Committee in the United Kingdom some years earlier.[87]

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[84] LRCS 1995. The Saskatchewan government chose instead to enact the UTIA.

[85] *Ibid.* at 7.

[86] *Ibid.* at 16.

[87] LRC 1982. See above at para. 29.

[83] Two propositions are implicit in the LRCS's 1995 endorsement of a refurbished legal list approach: (1) that a legal list of authorized investments provides guidance to unsophisticated trustees; and (2) there is no better way to provide such guidance. One response to this argument is that a list of authorized investments does not necessarily provide an unsophisticated trustee with any effective guidance as to how they should invest trust property. Legal lists tend to be long and convoluted, and it is doubtful that the typical unsophisticated trustee would take much comfort or derive much guidance from such a list. Although a legal list tells trustees what types of property they can or cannot invest in, it provides no guidance regarding the selection of securities from the list. And as we have already discussed, there is plenty of scope for an unsophisticated trustee who invests strictly within the confines of the legal list to put the real value of the trust's assets at serious risk.

[84] As an objection to the prudent investor rule, the "guidance" argument is not particularly persuasive. The rule need not simply direct trustees to invest "prudently" and leave trustees to figure out what that means. Although the prudent investor rule does not label particular investments as inherently prudent or imprudent, the legislative implementation of the rule can provide investors with a variety of guidelines and directions regarding the process of investing trust funds.

4. The Approach to Choosing a Default Rule

[85] Of course, whatever approach is taken–legal list or prudent investor–the statutory statement of trustee investment powers and duties serves merely as a default rule. A default rule of this sort can serve two related but distinct functions. The more obvious function is to provide direction for trustees where the trust's creator has simply not considered how the trustees should invest the trust funds. The other function is to provide known rules that a trust creator who *has* considered the issue of trustee investments can either expressly incorporate by reference or implicitly adopt by saying nothing about the matter in the trust instrument.

[86] One perspective is that in providing a default rule for trustee investments, the legislature should err on the side of caution by restricting trustees' default investment powers to a conservative list of safe investment instruments. Let trust

creators who want to allow trustees to speculate with the trust fund give them express permission to do so:

> The thrust of this Article is that the traditional prudent person rule needs some retuning, but that for family trusts it remains essentially a sound rule. This conclusion is premised upon the ultra-conservative purposes of the typical family trust, which are to provide a satisfactory income flow, to preserve if possible the purchasing power of principal, and to minimize loss of value in the event of severe economic decline. If more flexibility is desired in the form of more risk-taking in exchange for the potential for greater gain, or in the form of expansive experimentation pursuant to portfolio theory, the dispositive instrument can provide for it.[88]

In response to the foregoing argument, it may be observed that the prudent investor rule does not sanction careless speculation. It sanctions an approach to investing in which the trustee establishes investment objectives that balance expected return and risk and in which a potential investment is evaluated by considering its impact on the risk and expected return of the total portfolio.

[87] It has long been the case that in jurisdictions that retain the legal list approach as the default rule, professionally drafted trust instruments routinely reject it in favour of more liberal trustee investment powers.[89] All else being equal, the more appropriate of two possible default rules is that which is in fact chosen by most trust creators whose minds are directed to the issue. Why put the majority of trust creators, who want their trustees to have flexible investment powers, to the trouble and expense of "drafting around" a restrictive default rule, rather than leaving this task to the minority of trust creators who do not want their trustees to have flexible investment powers?[90]

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[88] Haskell 1990 at 87-88.

[89] Waters 1984 at 766 states, "Today some ninety percent of trusts authorize the trustees to invest as they in their discretion think best, or in some other language it is made clear that no restrictions are placed upon the trustees in their choice of investments." Similarly, the following statement regarding the U.K. *Trustee Investments Act 1961* appears in LRC 1982 at 16 (para.3.16): "However, the evidence we received made it clear that in the vast majority of cases the Act is either modified or wholly excluded in the trust instrument or will as the case may be." On the other hand, LRCS 1995 at 4 suggests that in Saskatchewan the proportion of trust instruments that give trustees more liberal invest powers than are provided by the statute may be lower than the figure mentioned by Waters, *ibid.*

[90] See Levy 1994 at 28.

B. Replacing the Legal List with the Prudent Investor

1. In General

[88] We believe that Alberta should follow the course of other jurisdictions that have adopted the prudent investor rule as the default standard for trustee investment. The legal list approach seems to be premised on the notion that the most effective means of preventing trustees from exposing the trust capital to undue risk is to confine them to investing in what the legislature has determined to be "safe" assets. We believe that the most effective approach that legislation can take to protecting the interests of trust beneficiaries is to provide trustees with the tools they need to invest trust assets effectively, and to do as much as legislative direction can do to ensure that trustees use the tools wisely. This is the thrust of the prudent investor approach.

RECOMMENDATION No. 1
The legal list approach to default trustee investment powers, as embodied in section 5 of the *Trustee Act*, should be replaced by the prudent investor rule.

2. Are there Contexts Where Prudent Investor Rule Should Not Apply?

[89] Our short answer to the question posed in the heading is that the prudent investor rule should apply except where a contrary intention is expressed by an instrument that creates a trust or by an enactment that deals with the investment powers of fiduciaries. This basic answer is elaborated below in the context of four specific issues. (1) Should certain trustees, namely unsophisticated trustees, remain subject to some version of the legal list approach? (2) How is the "contrary intention" qualification applied to existing enactments that define the investment powers of fiduciaries by referring to the investment provisions of the *Trustee Act*? (3) How is the "contrary intention" qualification applied to a trust that was created before the *Trustee Act* is amended to incorporate the prudent investor rule? (4) Should the legal list be preserved as an optional safe-harbour for trustees?

a. Unsophisticated Trustees

[90] It has sometimes been suggested that, while the prudent investor rule might be appropriate for sophisticated trustees, it is inappropriate for less sophisticated trustees or, perhaps, for trusts with few assets or other special characteristics. In its recent report, the BCLI noted that some respondents to its earlier consultation

paper "favoured restrictions on investment in the case of committeeships, small funds and trusts of minors' property," and that some "expressed concern that financially unsophisticated trustees may be left without guidance if the legal list is repealed."[91] The report's response to these concerns was as follows:

> The Committee considered all of these submissions carefully, but is not persuaded that a statutory list of authorized investment categories provides a satisfactory solution to any of the difficulties faced by the trustee or other fiduciary in the cases suggested by some correspondents as ones in which the range of investments should be limited. The statutory list is equally likely to become a trap for an inexperienced trustee as a guide, since the trustee may not be aware of the legislation and unwittingly depart from the list, thereby committing a breach of trust. It is also undesirable to restrict any trustee or fiduciary to categories of investments that may cease to be safe or productive with change in market conditions. Flexibility to deal with altered circumstances is as important to a trustee of a small fund as a large one.[92]

We agree with the BCLI's position on this issue, but we think something should also be said about a variation on the "unsophisticated trustees" argument.

[91] As mentioned earlier, in 1995 the Law Reform Commission of Saskatchewan recommended that Saskatchewan adopt a modified version of the legal list approach.[93] Unsophisticated trustees who wanted to go beyond a narrow list of permitted investments would be required to obtain expert advice before investing in securities identified in a broader list.[94] One might take a similar tack with the prudent investor rule. First, unsophisticated trustees could be allowed to invest without advice in assets identified in a legal list. Second, they could be allowed to invest in assets outside of the list only if they first obtain advice from a qualified investment adviser. But this is not an approach we would recommend.

[92] Later in the report we consider whether, but do not recommend that, unsophisticated trustees investing in accordance with the prudent investor rule be expressly required by the *Trustee Act* to obtain qualified investment advice. But *if* unsophisticated trustees were expressly required to get investment advice, it would be reasonable to ask why they should not be required to do so even if they are

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[91] BCLI 1999 at 8.

[92] *Ibid.*

[93] See above, para. 82.

[94] LRCS 1995 at 22.

investing within the confines of a legal list. We have observed already that a legal list will not in itself prevent an unsophisticated trustee from exposing the trust to undue risk, while conformity to a legal list may condemn the beneficiaries to receiving unduly low returns on their assets. In short, the argument for requiring unsophisticated trustees to obtain qualified investment advice applies whether they are investing within the bounds of a legal list or not.

b. Enactments that Refer to Trustee Act Investment Powers

[93] As indicated at the beginning of this report, many enactments define the investment powers of fiduciaries exercising investment powers under the enactment by referring to the investment powers of trustees under the *Trustee Act*.[95] The precise wording varies from enactment to enactment, but the following provisions are typical:

> a [condominium] corporation may invest any funds not immediately required by it only in those investments in which a trustee may invest under the *Trustee Act*.[96]
>
> If the board [of an irrigation district] invests in securities it shall only invest in those classes of securities enumerated in section 5 of the *Trustee Act*.[97]

[94] The existence of such references to the *Trustee Act*'s investment powers raises a policy question and a technical question. The policy question is whether it is appropriate to apply the prudent investor rule, as opposed to the legal list approach, to the fiduciaries to whom the referring enactment applies. The technical question is how the answer to the policy question is to be implemented for each referring enactment.

[95] We do not attempt to answer the policy question posed above for every enactment that currently defines the investment powers of fiduciaries by reference to the *Trustee Act*. As a general matter, though, it seems reasonable to start from the premise that the prudent investor rule should apply to the relevant fiduciaries unless there is some special reason why it should not.

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[95] A list of the statutes is set out in Appendix B.

[96] *Condominium Property Act*, R.S.A. 1980, c. C-22, s. 35.

[97] *Irrigation Act*, R.S.A. 1980, c. I-11, s. 48(3).

[96] One of the main virtues of the prudent investor rule is its flexibility and its adaptability to the terms, purposes and circumstances of a particular trust (or analogous fiduciary relationship). If a particular enactment's reference to the *Trustee Act*'s investment powers is read as incorporating the prudent investor rule, the fiduciaries to whom the enactment applies will in effect be directed to invest in accordance with standards of prudent investment, having regard to the purpose for which the invested funds are to be used. Given that the prudent investor rule emphasizes the importance of context-sensitive investment objectives, we find it hard to conceive of circumstances where the rule would be inappropriate for the context in which fiduciaries are exercising investment powers.

[97] If the policy is that the prudent investor rule should in general apply to fiduciaries acting under existing enactments that refer to the *Trustee Act*'s investment powers, the technical question posed above is easily answered. Under the ordinary rules of statutory interpretation, an enactment that refers to a provision of another enactment is to be read as referring to the other enactment, as it may be amended from time to time.[98] If, on the other hand, it is decided for some reason that fiduciaries acting under a referring enactment should still be subject to the legal list, special drafting effort would be required to achieve this result.[99]

i. The Dependent Adults Act

[98] For most enactments that incorporate the *Trustee Act*'s investment powers by reference, the exercise of investment powers by fiduciaries is peripheral to the main purposes of the Act. This is not so in the case of the *Dependent Adults Act* ("DAA"). One of its central concerns is the trusteeship of property of persons who are "unable to make reasonable judgments in respect of matters relating to all or any part of his estate."[100] In many respects, a trustee under the DAA is much like a trustee appointed by a will or other trust instrument, with a court order playing the role of the trust instrument. One difference between most ordinary trusts and a

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[98] *Interpretation Act*, R.S.A. 1980, c. I-7, s. 27.

[99] For wording that would achieve this result, see *Trustee Act*, R.S.O. 1990, c. T.23, s. 26, as am. by S.O. 1998, c. 18, Sched. B, s. 16. Ontario took the opposite approach to what we recommend. Pre-existing enactments that authorize investment in accordance with the *Trustee Act* are to be read as authorizing investments only in property in which trustees could invest before the *Trustee Act* was amended to adopt the prudent investor rule.

[100] *Dependent Adults Act*, s. 25(1)(b).

DAA trusteeship is that while the former will generally have two or more beneficiaries, the latter necessarily has only one beneficiary, the dependent adult.

[99] Section 29 of the DAA allows a trustee to do various things without obtaining the authority or direction of the court, including investing money "in investments in which trustees are authorized to invest trust money under the *Trustee Act*."[101] Section 30 then gives the Court the power to give trustees specific authority to do other things, one of which is to "invest funds in any securities and assets that the Court approves."[102] We are aware of only one reported decision, *Re Turnbull*,[103] in which a court has been asked to approve investment in securities or assets not mentioned in section 5 of the *Trustee Act*.

[100] The trustee in *Re Turnbull* applied for an "Order to allow absolute discretion with regard to investments, the power to invest in mutual funds, including those sold by Canada Trustco and the power to retain an investment counsellor or portfolio manager to manage the purchase and sale of securities of the estate."[104] The application was refused on the basis that there were "no compelling reasons, either in the submissions of counsel or in the affidavit filed in support of the application, to justify a deviation from the guidelines established in the Trustee Act."[105]

[101] In our view, the reasons that support adoption of the prudent investor rule for ordinary trusts apply also to trusteeship under the DAA. The flexibility of the prudent investor rule, and its direction to trustees to consider the circumstances of the trust when investing trust property seem to be well suited as a default rule for DAA trusteeships. If in a particular case the court considers that the trustee should be subject to a more restrictive investment regime, the court could include

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[101] *Ibid.* s. 29(b).

[102] *Ibid.*, s. 30(i).

[103] [1997] A.J. No. 1129, online: QL (CJ).

[104] *Ibid.* at para. 4.

[105] *Ibid.* at para. 11.

restrictions on the trustee's investment powers in the order appointing the trustee.[106]

[102] One commentator raised a specific concern regarding the application of the prudent investor rule in the context of a DAA trusteeship. The concern related to situations in which the dependent adult owns property, such as a lake cottage, that has special value or utility to the dependent adult, but which could not be justified as an "investment," based on its revenue potential or potential for appreciation. Unless the trusteeship order otherwise provides, would the trustee be required to sell the cottage because it is not a prudent investment?

[103] The short answer to the foregoing question seems to be that, in the absence of specific authorization from the court, the DAA trustee would have no power, let alone a duty, to sell a lake cottage or any other real property. If the *Trustee Act* is amended to incorporate the prudent investor rule, then the effect of section 29(b) of the DAA would be to allow a trustee under that Act to invest money in any type of property, in accordance with the standards of prudent investment. However, section 29 of the DAA only provides trustees with a very limited right to sell personal property,[107] and no right to sell real property, of the dependent adult. Thus, in order to sell a lake cottage or any other real property, the trustee would have to apply for specific authority to do so under DAA section 30(a).[108]

[104] Suppose, however, that a trustee under the DAA did have the authority to sell a lake cottage or some other item of property that was of special value or utility to the dependent adult. Assume that the property in question has no revenue potential and is likely to depreciate, rather than appreciate, in value. Would the prudent investor rule require the trustee to ignore the special subjective value of this property to the dependent adult and sell it because it will not appreciate in value or produce any revenue? It would not. In fact, the UTIA specifically permits, and we

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[106] The opening words of DAA s. 29 make it clear that any of the powers enumerated in that section, including the investment power, may be subject to conditions or restrictions imposed by the court.

[107] DAA section 29(i) allows the trustee to sell personal property having a fair market value not exceeding a prescribed amount. The prescribed amount is an aggregate of $10,000 during the trusteeship: Dependent Adult Regulation, Alta. Reg. 289/81, s. 5.3 (as am. by Alta. Reg. 264/85).

[108] See e.g. *Jonsson v. Perrault* [1998] A.J. No. 1235, online: QL (CJ).

would specifically require, a trustee to consider "an asset's special relationship or special value, if any, to the purposes of the trust or to one or more of the beneficiaries."[109]

[105] Even in the absence of such a specific direction, the overriding concern of the prudent investor rule is that the trustee invest trust property in a manner that is suited to the circumstances of the trust. In the case of a DAA trusteeship, one of the circumstances that it would be important for a trustee to consider is the special utility or subjective value to the dependent adult of any of their property.

ii. Enduring Powers of Attorney

[106] The *Powers of Attorney Act*[110] allows a person (the "donor") to appoint someone as their "attorney" to act for them should the donor become mentally incapacitated or otherwise unable to manage their own affairs. An attorney acting under such an "enduring" power of attorney fulfills essentially the same function as a trustee appointed under the DAA. The principal difference is that the attorney is chosen and the attorney's powers defined by the donor rather than by a court.

[107] Although the functions of a DAA trustee and an attorney under an enduring power of attorney are similar, their default investment powers are very different under the current law. While the trustee is by default confined to investing in accordance with section 5 of the *Trustee Act*, the attorney is given very broad default powers. Section 7 of the *Powers of Attorney Act* provides as follows:

> Subject to this Act and any terms contained in an enduring power of attorney, an attorney
>
> (a) has authority to do anything on behalf of the donor that the donor may lawfully do by an attorney . . .

[108] Section 7(a) would give the attorney authority to invest money of the donor in any type of property. In this respect, section 7(a) is like the prudent investor rule. However, unlike statutes that implement the prudent investor rule, the *Powers of Attorney Act* does to specify standards to which the attorney must adhere in making investment decisions. Given the similarity between the functions of an attorney under an enduring power of attorney and a DAA trustee (or other trustees,

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[109] UTIA s. 1(3)(h). See below, Recommendation 6(c).

[110] S.A. 1991, c. P-13.5.

for that matter), we believe that the former should be subject to the same prudent investment standards as the latter when exercising investment powers.

RECOMMENDATION No. 2
The *Powers of Attorney Act* should be amended to make it clear that, unless an enduring power of attorney provides otherwise, the attorney must exercise a power of investment in accordance with the standards of prudent investment as set out in the *Trustee Act*.

c. Pre-existing Trusts

[109] A trust may last for decades. Thus, it would not be particularly remarkable for a trust that came into effect many years before an amendment to the *Trustee Act* to still be in effect many years after the amendment. In Recommendation 3, below, we recommend that, subject to a contrary intention expressed in the trust instrument, the prudent investor rule should apply to trusts created before the *Trustee Act* is amended to incorporate the prudent investor rule. So far as we are able to determine, this is the approach that has been taken in every jurisdiction that has switched from the legal list approach to the prudent investor rule.

[110] To say that the prudent investor rule should apply to pre-existing trusts unless a contrary intention is expressed in the trust instrument raises an obvious question. How assiduous should a court be to find such a contrary intention in the trust instrument? Suppose that the trust instrument contains words to the effect that the trustee may invest in investments authorized by the *Trustee Act*. Should this be taken as expressing the trust creator's intention to adopt the Act's list of permitted investments as it existed when the trust came into effect, so that allowing the trustee to invest in accordance with the prudent investor rule would be contrary to the trust creator's expressed intention? We think not.[111]

[111] We suspect that few trust creators who in the past have adopted the *Trustee Act*'s investment powers (by reference or by silence) intended to commit their

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[111] The English and Scottish Law Commissions framed their recommendation regarding contrary intent so as to specifically negate the possibility that a contrary intention would be inferred from a trust instrument's reference to investment powers under the *Trustee Investments Act 1961*: LC & SLC 1999 at 31 (para. 2.52).

trustees for all time to the specific investment powers of the Act as it read at some particular moment in time.[112] It is more likely that they intended to authorize their trustees to invest in a manner that meets trustee investment standards that are determined to be appropriate by the Legislature from time to time in light of existing conditions. Therefore, we think that only a clear indication of the trust creator's intention to restrict the trustee to a particular range of investments, such as those found in section 5 of the *Trustee Act* at a particular point in time, should prevent the prudent investor rule from being applied to a pre-existing trust.

d. Legal List as an Optional Safe Harbour

[112] It has been argued that even if the legal list is done away with as a *constraint* on trustee investments, it should be preserved as a *safe harbour* for trustees. That is, trustees who decide to venture beyond the confines of a legal list should be held to the standard of prudent investment, but trustees who stay within its confines should be presumed to have acted prudently. Trustees who stayed within the list would not have to worry about their investment decisions being called into question after the fact by disgruntled beneficiaries on the basis that the trustee did not invest prudently.

[113] One problem with the foregoing argument is that even under the existing legal list approach, trustees owe a general duty of care and prudence that is not suspended or presumed to have been met simply because the trustee stays within the confines of the legal list. A trustee who goes beyond the legal list (or the express investment powers set out in the trust instrument) is certainly guilty of at least a technical breach of trust. But a trustee who stays within the list has not necessarily satisfied the general duty of care and prudence. The point was put thus by the MLRC in its 1982 report:

> The Commission also noted that support for the legal list position seemed to be founded to a large extent on two misconceptions. The first misconception

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[112] Suppose that it was concluded that trust creators who incorporated the *Trustee Act*'s investment powers by reference must have intended to adopt the Act's investment powers as they existed when the trust came into effect, and that this intention should govern. This would have serious implications in the context of the tinkering that has gone on with the legal list over the years. Suppose, for example, that a trust instrument came into effect in 1965 and the trust was still in existence in the 1990s. If the trust creator's intention governs and one concludes that the trust creator meant to adopt the investment provisions of the *Trustee Act* as they existed in 1965, one must conclude that the trustee could not invest in, say, shares of the Alberta Energy Company, because they were not added to the legal list until 1974.

> is that if a trustee follows the legal list he will be immune from being sued. . . Neither proposition can be supported in law. . .
>
> Dealing first with the question of immunity. Section 70(2) of *The Trustee Act* commences by saying ". . . if the investment is in all other respects reasonable and proper . . . ".[112] These words are a clear indication that the Legislature never intended to provide immunity to the trustee who merely followed the legal list; the trustee must still exercise reasonable care. . .[114]

The Manitoba report then discusses case law supporting its contention that adherence to the legal list does not absolve a trustee from responsibility for acting prudently.[115]

[114] Of course, the fact that under the existing legal list approach trustees who confine themselves to authorized investments are not automatically immunized from allegations of imprudence does not mean that an amended Act could not do so. For example, the Act could set out a list of "safe" investments and specify that investment of trust funds in any of those investments is deemed to be prudent.[116] However, while the provision of such a safe harbour might appeal to some trustees–and it is always open to a trust creator expressly to provide such a safe harbour–it could have unfortunate consequences for a trust's beneficiaries.

[115] Presumably, specifying a list of investments that would act as a safe harbour would encourage trustees who wish to avoid potential liability to invest only in the investments identified in the list. A trust portfolio that is confined to such investments might well condemn the beneficiaries to receiving unnecessarily modest returns from the trust's investments compared to the returns that could be realized from a diversified portfolio. Moreover, as discussed earlier, there is plenty of scope within section 5 of the *Trustee Act* for an imprudent or unsophisticated trustee to subject the trust to undue risk. In short, preserving the legal list (or some version of the legal list) as a safe harbour for trustees would put the interests of certain unsophisticated trustees ahead of the interests of the beneficiaries of the

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[113] The introductory part of section 5 of Alberta's *Trustee Act* contains the identical phrase.

[114] MLRC 1982 at 8-9.

[115] *Ibid.*, at 9-10.

[116] This approach is taken by Quebec's Civil Code, which restricts administrators to investing in a list of investments that are "presumed sound," and provides that an administrator who invests in accordance with the relevant section "is presumed to act prudently:" Arts. 1339 and 1343, C.C.Q.

trust. As the MLRC put it, "[t]he original purpose of the legal list was to protect the beneficiaries of the trust, not the incompetent trustee."[117]

[116] One of the commentators on our consultation memorandum, although not a supporter of the general "safe-harbour" approach, thought that there should be a phase-in period for the prudent investor rule with respect to existing trusts. This commentator's concern was that the adoption of the prudent investor rule should not require trustees of existing trusts to suddenly restructure their portfolio to bring it into conformity with prudent investment standards the moment the amendments to the *Trustee Act* come into force. The commentator thought that a phase-in period of perhaps five years, during which trustees of existing trusts could comply with either the legal list or prudent investor approach, would be appropriate to address this concern.

[117] We agree that trustees who have a portfolio of legal-list investments should not be required to rush out and convert GICs, bonds and other legal-list investments to equities the moment that the prudent investor rule comes into effect. We do not, however, think it is necessary to provide a specific phase-in period for the prudent investor rule.

[118] The overriding demand of the prudent investor rule is that trustees exhibit prudence in making investment decisions. Suppose that a trustee has a legal-list portfolio at the moment the prudent investor rule comes into force. The prudent thing for this trustee to do is to review carefully the existing portfolio in light of the purposes of the trust and to consider how these purposes may best be served, given the expanded investment opportunities available to the trustee under the prudent investor regime. This review may well lead the trustee to conclude that a significant restructuring of the portfolio is appropriate. But having reached this conclusion, the prudent trustee will also give consideration to the process and timing of this restructuring. It is highly unlikely that this will lead the prudent trustee to the conclusion that best way to achieve the restructuring is by a sudden conversion of a large proportion the portfolio from legal-list investments into equities (or other forms of property that did not grace the legal list).

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[117] MLRC 1982 at 10.

RECOMMENDATION No. 3
Subject to a contrary intention expressed in a trust instrument or an enactment that defines the investment powers of fiduciaries by reference to the *Trustee Act's* investment provisions, the prudent investor rule should govern investment by all trustees and by such fiduciaries, regardless of whether the trust is created or the enactment is enacted before or after the *Trustee Act* is amended to adopt the prudent investor rule.

C. Implementing the Prudent Investor Approach

[119] In Division B we said that the prudent investor rule should be the default rule for all trusts. Here in Division C we consider what the prudent investor rule should permit or require trustees to do in investing trust funds. It should be kept in mind that whenever we say that the prudent investor rule would (or should) permit or require trustees to do something, this is subject to a contrary intention expressed in the trust instrument.

1. The Uniform Trustee Investment Act, 1997

[120] As previously indicated, the UTIA was adopted by the ULCC in 1997. At the time the UTIA was adopted, three provinces–Manitoba, Nova Scotia and New Brunswick–and the two (as they then were) territories had already adopted either the prudent man or prudent investor approach. Three provinces–Prince Edward Island, Ontario and Saskatchewan–have subsequently adopted the prudent investor approach. Prince Edward Island enacted the UTIA without modification, while Ontario and Saskatchewan have enacted the UTIA with certain modifications.

[121] In British Columbia, the BCLI has recently recommended adoption of the prudent investor rule. The BCLI report, however recommends that British Columbia not follow the UTIA on certain issues. Similarly, the MLRC's recent report recommends that Manitoba's *Trustee Act* be amended to incorporate some, but not all, of the elements of the UTIA that are not currently found in Manitoba's Act.

[122] The preceding two paragraphs indicate that while the UTIA serves as a useful model for implementing the prudent investor rule, Alberta would not be

setting a precedent if it were to make certain modifications to the UTIA when enacting the prudent investor rule. Thus, in considering what recommendations to make on specific issues addressed by the UTIA, we have regarded the UTIA's approach as the presumptive favourite, but a favourite that may be displaced or modified where there seems to be good reason for doing so. Some of our recommendations do in fact take an approach that differs slightly from that of the UTIA. However, none of the differences between legislation based strictly on our recommendations and legislation identical to the UTIA should result in differences in the way trustees would go about the day-to-day task of investing trust property.

2. The Prudent Investor Standard

[123] This section addresses two related issues. First, in what sorts of property should a trustee be able to invest trust funds? Second, how, in general terms, should the trustee go about the task of investing trust funds? The relevant provisions of the UTIA are sections 1(1), 1(2) and 2.

> 01 (1) A trustee may invest trust property in any form of property or security in which a prudent investor might invest including a security issued by a mutual fund as defined in the [name of statute in jurisdiction regulating securities].
>
> (2) Subsection (1) does not authorize a trustee to invest in a manner that is inconsistent with the trust.
>
> 02 In investing trust property, a trustee must exercise the care, skill, diligence and judgment that a prudent investor would exercise in making investments.

a. Types of Property in Which Trust Funds may be Invested

[124] Dealing first with the types of property in which a trustee may invest trust funds, we do not think that the *Trustee Act* should put any express constraints on the type of property in which a trustee may invest trust funds. The constraints on trustee investment decisions should take the form not of express restrictions on the type of property in which trustees may invest, but of standards for how they go about making their investment decisions.

[125] We believe that the foregoing is the premise that underlies UTIA section 1(1). But we are somewhat troubled by the phrase, "may invest . . . in any form of property *in which a prudent investor might invest*." The italicized portion of this phrase seems to imply that there are certain types of property in which a prudent

investor would never invest. However, the text of the UTIA provides no clue as to what these types of forbidden property might be.

[126] Rather than referring to types of property in which "a prudent trustee might invest," we would prefer wording to the effect that a trustee may invest in any type of property, provided that the investment is in accordance with the standards of prudent investment. The reference to investing in accordance with the standards of prudent investment emphasizes the importance of making investment decisions in accordance with criteria that are appropriate to the circumstances of the particular trust.

[127] UTIA section 1(1) says that the property in which a trustee may invest trust funds includes mutual funds. We certainly agree that trustees should be able to invest in mutual funds. But we do not believe it is necessary or advisable to refer specifically to mutual funds when saying that trustees may invest trust funds in any type of property. We do not think that anyone would seriously doubt that mutual funds are a form of property or that the general statement that trustees may invest in any form of property would include mutual funds.

[128] Under the existing law, there are two independent reasons why trustees cannot invest in mutual funds unless authorized to do so by the trust instrument. First, mutual funds per se are not mentioned in the legal list, and trustees must invest within the bounds of the list. Second, there is authority to the effect that a trustee investing in a mutual fund would be improperly delegating decision-making authority to the fund manager.[118] The first reason is dealt with by abandoning the legal list. The second is dealt with in UTIA section 7(7), which provides that investment in a mutual fund is not delegation of investment authority.

[129] Later in this chapter we recommend that Alberta adopt a provision along the lines of UTIA section 7(7).[119] We think it would be redundant to say that the property in which a trustee may invest includes mutual funds. Although there is perhaps no harm in specifically referring to mutual funds, the specific reference to

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[118] *Haslam v. Haslam* (1994), 114 D.L.R. (4th) 562 (Ont. Gen. Div.).

[119] See Recommendation 13.

mutual funds might raise a question about other "exotic" forms of property, such as option contracts, that are not specifically referred to in the section.

RECOMMENDATION No. 4
Subject to the terms of the trust, a trustee should be able to invest trust property in any form of property, provided that the investment is made in accordance with the standards of prudent investment as set out in the *Trustee Act*.

b. How Trustees Should Make Investment Decisions

[130] So what are the standards of prudent investment? The starting point for answering this question is to be found in judicial statements of the general standard of care to which trustees are subject. The following statement of this standard, although uttered over 100 hundred years ago, is still regarded as authoritative:

> As a general rule the law requires of a trustee no higher degree of diligence in the execution of his office than a man of ordinary prudence would exercise in the management of his own private affairs. Yet he is not allowed the same discretion in investing the moneys of the trust as if he were a person sui juris dealing with his own estate. Business men of ordinary prudence may, and frequently do, select investments which are more or less of a speculative character; but it is the duty of a trustee to confine himself to the class of investments which are permitted by the trust, and likewise to avoid all investments of that class which are attended with hazard.[120]

The first part of this passage–the reference to the diligence of a person of ordinary prudence–could serve as a general description of, or at least an introduction to, the prudent investment standard.[121] The second part of the passage, if applied in the context of the prudent investor rule, would require some qualification. The trustee would certainly be required to avoid "hazard" in the sense of taking on undue risk. But hazard or risk would be assessed on a portfolio-wide basis, rather than by focussing on particular assets in isolation.

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[120] *Learoyd v. Whitely* (1887), 12 App. Cas. 727 at 733 (per Lord Watson). The last sentence of the passage emphasizes the point we made earlier regarding the legal list as a safe harbour. That trustees invest within the range of authorized investments does not relieve them of the duty to exercise prudence.

[121] In *Fales v. Canada Permanent Trust Co.*[1977] 2 S.C.R. 302, at 315, *Learoyd v. Whitely*, *ibid.*, is referred to as the source of the traditional statement of the standard of care expected of trustees in the administration of an estate.

[131] Section 2 of the UTIA says that a trustee's duty is to "exercise the care, skill, diligence and judgment that a prudent investor would exercise in making investments." Even as a general statutory statement of the prudent investor standard, the UTIA section seems to raise without answering the question of what care, skill, diligence and judgment would be exercised by a prudent investor. Anyone who has read the literature regarding the prudent investor rule and the portfolio approach will know that the reference to a "prudent investor" is intended to incorporate the portfolio approach to investing. However, we think the *Trustee Act* should state the general prudent investor standard in terms that are somewhat more descriptive of what is expected of trustees than the bald reference to a "prudent investor."[122]

[132] In our consultation memorandum we invited comment on various possible formulations of the general prudent investor standard, based on wording found in the UTIA, the American UPIA and actual legislation in several different provinces. The comments that we received, as well as the reflections of our Project Committee and Board, suggest that each of the formulations has its own strengths and weaknesses. We believe, however, that the statutory provision or provisions should be expressed in language that captures several critical ideas.

[133] First, the general statement of the prudent investor standard should make it clear that the statutory standard may be trumped by the terms of the trust instrument. Second, trustees should determine investment objectives and strategies in light of the circumstances of the particular trust. By "circumstances of the particular trust," we mean to include such factors as the trust's purpose and expected duration, the size of the trust fund, the needs and circumstances of the beneficiaries, and so on. Investment objectives or strategies that are perfectly appropriate to the circumstances of one trust might be totally inappropriate to the circumstances of another. Third, the trustee should establish investment objectives and strategies that strike an appropriate balance between expected return and risk, having regard to the circumstances of the trust. Finally, the general statement of the standard should emphasize that in evaluating risk and return, the trustee should view particular investment decisions in the context of the overall portfolio, rather than in isolation.

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[122] The UTIA does not expressly define the term "prudent investor."

[134] We believe that the general statement of the prudent investor standard should refer to periodic review of the trust portfolio. An investment approach, or a particular investment, that is appropriate to the circumstances of the trust at one point in time will not necessarily remain so indefinitely.[123] That a trustee should review the trust portfolio at reasonable intervals is probably implicit in the general notion of prudent investment. Nevertheless, we believe that the general statutory expression of the prudent investor standard should emphasize the importance of reviewing the trust portfolio at reasonable intervals.

RECOMMENDATION No. 5

(a) Subject to the terms of the trust, the *Trustee Act* should require trustees to invest trust property with a view to obtaining a reasonable return while avoiding undue risk, having regard to the circumstances of the trust.

(b) The *Trustee Act* should direct trustees to evaluate the expected return and risk associated with investment strategies or decisions within the context of the overall trust portfolio, rather than by focussing on particular investments in isolation.

(c) The *Trustee Act* should require trustees to review the trust portfolio at reasonable intervals for the purpose of confirming that the portfolio continues to be appropriate to the circumstances of the trust.

c. *A Dual Standard of Care and Skill?*

[135] We have described Recommendation 5 as the general statement of the prudent investment standard. It is a general description of how trustees should go about the tasks of determining and pursuing their investment objectives. It does

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[123] One obvious purpose of a review would be to identify securities that no longer satisfy the criteria that made them suitable candidates for inclusion in the portfolio in the first place. However, the purpose of the review might be broader than that. Suppose, for example, that the trustee's overall investment strategy calls for a 70:30 ratio between equities and fixed income securities. A periodic review indicates that, because of the superior performance of equity markets since the trust's inception (or the previous review), the ratio is currently 90:10. This suggests that the trustee should consider taking steps to bring the ratio back into line with the trustee's own asset-allocation guidelines. However, the trustee might also take this opportunity to reconsider its asset allocation guidelines. The crucial point is that the trustee should bring its mind to bear on the matter.

not, however, describe the *standard of care and skill* against which the performance of trustees in carrying out these tasks is to be measured. For example, Recommendation 5(a) would direct the trustee to invest trust property "with a view to obtaining a reasonable return while avoiding undue risk, having regard to the circumstances of the trust." The recommendation does not purport to describe the standard against which the trustee's efforts to comply with this direction should be judged, should the need to judge arise.[124]

[136] Should a trustee's efforts to discharge their duties with respect to the investment of trust property be measured against that trustee's own capabilities: a subjective test? Or should all trustees' efforts be measured against a single objective standard, and if so, should the standard be very high, very low, or somewhere in between? Or perhaps there should be one objective standard for the "amateur" trustee and another objective standard for the "pro," or for those who holds themselves out as having special expertise in investment matters.

[137] The traditional view is that all trustees should be held to a single, objective standard of care:

> Traditionally, the standard of care and diligence required of a trustee in administering a trust is that of a man of ordinary prudence in managing his own affairs . . . and traditionally the standard has applied equally to professional and non-professional trustees. The standard has been of general application and objective though, at times, rigorous.[125]

One way of describing the traditional standard is to say that no more skill and sagacity is expected of an investment professional than of an amateur trustee with no investment experience. Another way of saying the same thing, but with a different emphasis, is that the amateur trustee with no previous investment experience is held to the same standard of skill and sagacity as the investment professional.

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[124] We have already noted that while UTIA section 2 specifies that "a trustee must exercise the care, skill, diligence and judgment [of] a prudent investor," the UTIA does not go on to describe how much of each of these qualities (e.g. skill) one might expect to find in the prudent investor. In reality, the UTIA leaves the definition of the standard of care and skill to the courts. While the UTIA makes it clear that the trustee should take the "portfolio approach" to investing, it does not attempt to define how much proficiency is expected of trustees in their efforts to adopt the portfolio approach.

[125] *Fales v. Canada Permanent Trust* [1977] 2 S.C.R. 302 at 315.

[138] The Commentary on UTIA section 2 mentions that the corresponding provision in the American UPIA "sets out a similar standard, but also requires trustees with special expertise or skill to exercise the capabilities or skill they profess to have." The Commentary then says that the same result can be achieved in Canada by other means:

> In Canada, the same result is possible because of the provisions of the Trustee Acts allowing discretionary relief from liability for technical breaches of trust where the trustee has acted honestly and reasonably. It is harder for professional trustees to obtain discretionary relief.

[139] The provision referred to in the foregoing passage is section 41 of the *Trustee Act*, and its equivalent in other provinces:

> 41 If in any proceedings affecting trustees or trust property it appears to the court
>
> (a) that a trustee . . . is or might be personally liable for any breach . . . but
>
> (b) that the trustee has acted honestly and reasonably and ought fairly to be excused for the breach of trust . . .
>
> then the court may relieve the trustee either wholly or partly from personal liability for the breach of trust.

In *Fales v. Canada Permanent Trust* the Supreme Court of Canada applied this provision (actually, its British Columbia equivalent) so as to relieve a testator's widow of liability for bad investment decisions while refusing to grant relief to the widow's professional co-trustee:

> A trustee is not expected to be infallible nor is a trustee the guarantor of the safety of estate assets and I have no doubt that in an appropriate case a paid professional trustee may seek and obtain relief under s. 98 [Alberta section 41]. Section 98 in terms admits of that possibility. All of the circumstances would have to be considered, including whether the trustee was paid for its services. . . Among other relevant considerations is whether the breach was merely technical in nature or a minor error in judgment; whether decline in value of securities was attributable to general economic conditions; whether the trustee is someone who accepted a single trust to oblige a friend or is a company organized for the purpose of administering estates and presumably chosen in the expectation that it will have specialized departments and experienced officials; above all, whether the conduct of the trustee was reasonable. The actions, or inaction, on the part of Canada Permanent which gave rise to the breach of trust in the present instance were not reasonable in my view.[126]

When it came time to consider the widow's plea for relief, the Court, focussing on her lack of investment experience, held that she had acted reasonably in the

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[126] *Ibid.* at 319-20.

circumstances.[127] Although the Court did not explicitly impose a higher standard of care or skill on the professional trustee, its different treatment of the two trustees' plea for discretionary relief arguably had much the same effect.

[140] In its 1996 report to the ULCC on the prudent investor rule, the Law Reform Commission of British Columbia ("LRCBC") summarized the arguments for and against a legislated dual standard:

> Arguments in favour of a dual standard of care focus on the fact that professional trustees hold themselves out as having special knowledge and skill, particularly in relation to investment. If professionals claim to be better at managing trust property than non-professional trustees by virtue of their special skills, should they not be expected to obtain better results? Against this is the argument that "prudence is prudence" and any attempt to distinguish between the degree of prudence that paid trustees would exhibit and the prudence of unpaid trustees is bound to be artificial.[128]

The report also noted that a dual standard might complicate the law unnecessarily, by creating problems of defining what sort of trustee is held to which standard, and complicate breach of trust actions by making it necessary to determine the operational differences between the two standards.[129]

[141] We note that it is not only in the United States, but also in Australia, New Zealand and the UK that experts, or persons who hold themselves out as experts, are expressly held to a higher standard than non-expert trustees. The following, which is typical of the Australian and New Zealand Provisions, is from section 14A of the New South Wales *Trustee Act 1925*:

> (2) A trustee must, in exercising a power of investment:
>
> (a) if the trustee's profession, business or employment is or includes acting as a trustee or investing money on behalf of other persons, exercise the care, diligence and skill that a prudent person engaged in that profession, business or employment would exercise in managing the affairs of other persons, or
>
> (b) if the trustee is not engaged in such a profession, business or employment, exercise the care, diligence and skill that a prudent person would exercise in managing the affairs of other persons.

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[127] *Ibid.* at 324-25.

[128] LRCBC 1996 at 11 (para. 40).

[129] *Ibid.* (paras 42-43).

[142] In the UK the Law Commissions recently made the following observation regarding the position at common law:

> As a general principle, it seems that remunerated and professional trustees are expected to meet a higher standard than other trustees, and a trustee which holds itself out as having special expertise beyond that of the ordinary prudent person may be held to account if loss is incurred by the trust as a result of a failure to exercise that level of expertise.[130]

Section 1 of the draft Bill included in the Law Commissions' report would give statutory form to the foregoing:

> (1) Whenever the duty under this subsection applies to a trustee, he must exercise such care and skill as is reasonable in the circumstances, having regard in particular –
>
> (a) to any special knowledge or experience that he has or holds himself out as having, and
>
> (b) if he acts as trustee in the course of a business or profession, to any special knowledge or experience that it is reasonable to expect of a person acting in the course of that kind of business or profession.[131]

[143] The Law Commissions' provision has considerable attraction. In the vernacular, it emphasizes that "if you talk the talk, you'd better walk the walk." Moreover, it would be flexible, emphasizing that what is ultimately required of a trustee is the degree of care and skill that is reasonable in the circumstances. Nevertheless, we do have some concern about the idea of introducing subjective, trustee-specific (or profession-specific) criteria at the "front-end,"when determining the standard of care and skill. There is something to be said for a single, robust, objective standard of care and skill that all trustees must meet in the first instance. This would leave subjective criteria to be considered, if necessary, when determining whether to grant discretionary relief under section 41 of the *Trustee Act* where a trustee has not met the objective standard.

[144] On balance, we have decided not to recommend that the *Trustee Act* be amended to include a provision expressly imposing a higher standard of care on professional trustees or trustees who hold themselves out as having special expertise. We emphasize that we have *not* concluded that it would necessarily be inappropriate for the *Trustee Act* to contain such a provision or for the courts to

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[130] LC & SLC 1999 at 16 (para. 2.15). The authority cited for the "holding out" proposition, *Bartlett v. Barclays Bank Trust Co* [1980] Ch. 515 was decided after the Supreme Court of Canada's decision in *Fales*.

[131] LC & SLC 1999 at 96.

expressly impose a higher standard on certain classes of trustees. Rather, we simply are not convinced that a compelling case has been made out for inserting such a provision in the *Trustee Act*. We are not satisfied that such a provision would necessarily provide any particular advantage over the combination of a judicially-determined standard of care and skill and the discretionary relief mechanism of section 41.

d. Matters to be Considered in Planning Trust Investments

[145] We come now to a matter upon which there is considerable controversy. Having stated the general prudent investor standard, should the *Trustee Act* then set out a list of matters for trustees to consider in establishing an investment strategy or in making particular investment decisions?

i. Possible Approaches

[146] There are three basic alternatives. The first is that the Act does not set out a list of matters to be considered. The second is that the Act sets out a "permissive list," a list of matters that trustees *may* consider along with other factors not mentioned in the list. Finally, the Act could set out a "mandatory list," a list of matters that trustees *must* consider (to the extent they are relevant to the circumstances of a particular trust) along with unlisted matters that may be relevant. Of course, if there is to be a list, there is then the question of what it should contain.

[147] The diversity of law-reformer and legislative opinion on this subject can be illustrated by a brief survey of what has been done or recommended in other jurisdictions. UTIA section 1(3) sets out a permissive list:

> (3) A trustee may have regard to the following criteria in planning the investment of trust property, in addition to any others that are relevant to the circumstances:
>
> (a) general economic conditions;
>
> (b) the possible effect of inflation or deflation;
>
> (c) the expected tax consequences of investment decisions or strategies;
>
> (d) the role that each investment or course of action plays within the overall trust portfolio;
>
> (e) the expected total return from income and the appreciation of capital;
>
> (f) other resources of the beneficiaries;
>
> (g) needs for liquidity, regularity of income and preservation or appreciation of capital;

> (h) an asset's special relationship or special value, if any, to the purposes of the trust or to one or more of the beneficiaries.

[148] The UTIA list is virtually identical to the list in the American UPIA. However, the latter *requires* trustees to consider the matters in the list, insofar as they "are relevant to the trust or its beneficiaries."[132]

[149] As mentioned earlier in this report, three provinces have enacted the UTIA, with or without modifications. Prince Edward Island enacted the UTIA without modification, so it has adopted the latter's permissive list approach. Both Saskatchewan and Ontario, however, have made it mandatory for trustees to consider the matters in the list. Essentially, all that Ontario and Saskatchewan have done is substitute "shall"[133] or "must"[134] for the UTIA's "may" in the introductory part of the provision.

[150] Looking further afield, New Zealand's prudent investor legislation of 1988 contains a list of factors to which trustees may have regard in making investment decisions:

> Without limiting the matters that a trustee may take into account, a trustee exercising any power of investment may have regard to the following matters so far as they are appropriate to the circumstances of the trust:[135]

This is followed by a twelve-clause list.

[151] When the Australian states adopted prudent investor legislation beginning in the mid-nineties, they adopted a somewhat expanded version of the New Zealand list. However, most of the Australian states have substituted "shall" or

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[132] The complete wording of the introductory part of UPIA s. 2(c) is, "Among circumstances that a trustee shall consider in investing and managing trust assets are such of the following as are relevant to the trust or its beneficiaries."

[133] *Trustee Act*, R.S.S. 1978, c. T-23, s. 3(3), as am. by S.S. 1998, c. 40.

[134] *Trustee Act*, R.S.O. 1990, c. T.23, s. 27(5), as am. by S.O. 1998, c. 18, Sched. B, s. 16.

[135] *Trustee Act 1956*, s. 13E, as am. by 1988, No. 119 (N.Z.).

"must" for "may" in the introductory clause.[136] The exception is Tasmania, which has followed the permissive approach.[137]

[152] In its recent report the BCLI argued against including either a permissive or mandatory list of factors to be considered by trustees in making investment decisions.[138] After noting that a few respondents to its consultation paper favoured a permissive list and none favoured a mandatory list, the report continued:

> Over the course of time guidelines may be seen as a checklist that must be gone through in order for an investment decision to be considered prudent in a legal sense. The standard of "prudence" might thus become equivalent to a mechanical process of demonstrating compliance with the checklist rather than a careful analysis of risk and return in light of prevailing conditions. It is unlikely that less sophisticated trustees would be assisted to any great degree by the inclusion of guidelines such as those listed above, as they will require expert advice in any event in order to assess tax consequences and inflation. More sophisticated trustees will be aware that factors such as those listed in (a) to (h) above play a part in every well-considered investment decision. The Committee does not see guidelines as necessary or desirable, and we do not recommend their inclusion in the legislation.

In its recent report, the MLRC expressed the view that the list of factors should be in regulations under the *Trustee Act*, rather than in the Act itself.[139] The MLRC report does not take a position on whether consideration of the criteria should be mandatory or permissive.

ii. No Point to a Permissive List

[153] In our view, there would be little point in the *Trustee Act*'s setting out a permissive, non-exclusive list of matters that trustees may consider when investing trust property. The passage from the BCLI report set out in the preceding paragraph indicates that, over the course of time, "guidelines may be seen as a checklist that must be gone through in order for an investment decision to be considered prudent in a legal sense." We doubt that this would happen in the case of a provision that says, in effect, that the trustee may consider certain specified

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[136] *Trustee Act 1925* (NSW), s. 14C; *Trustee Act* (NT), s. 8(1); *Trustee Act 1936* (SA), s. 9; *Trustee Act 1958* (VIC), s. 8; *Trustees Act 1962* (WA), s. 20(1); *Trusts Act 1973* (QLD), s. 24(1) (as amended by *Trusts (Investments) Amendment Act 1999* (QLD), unproclaimed as of December 1999).

[137] *Trustee Act 1898* (TAS), s. 8.

[138] BCLI 1999 at 9-10.

[139] MLRC 1999 at 14-15.

matters, as well as others that may be relevant. We suspect that the more likely fate of such a provision is that it would simply be ignored.

[154] There would be some point in a statutory provision that says that trustees may consider certain specified factors "in addition to any others that are relevant" if there otherwise might be some doubt whether it was permissible for trustees to consider the specified factors. But whether the *Trustee Act* says so or not, there is no obvious reason to doubt that a trustee investing in accordance with the prudent investor standard could properly consider the factors mentioned in the UTIA list (or in the longer lists found in the New Zealand and Australian statutes). In our view, the statutory list of matters for trustees to consider should either be mandatory (in the sense described below) or there should be no list at all.

iii. Rationale for and Structure of a Mandatory List

[155] In deciding whether to recommend that trustees be required to consider certain matters when planning investments, we think it is useful to consider a couple of questions. The first is whether it is possible to identify certain matters that trustees generally *ought* to consider when planning how to invest trust property. For this purpose, we assume that a trustee "ought to consider" a matter if a trustee who does so is more likely to adopt and follow an optimal investment strategy than one who does not. If we can identify such matters, there is a rationale for *requiring* trustees to consider them when planning the investment of trust property. Assuming that there is a rationale for requiring trustees to consider certain matters, the final question is whether there are objections to imposing the requirement that are more cogent than the rationale for imposing it.

[156] It does not seem difficult to answer the first question posed above in the affirmative. Certain matters will often have such a significant impact on the efficacy of investment strategies that trustees who ignore them are likely to significantly diminish their chances of adopting an optimal investment strategy. In the first place, it will be rather difficult for a trustee (or anyone else) to develop an optimal investment strategy unless they have a fairly concrete idea of the objectives that their strategy will be designed to accomplish.

[157] In order to establish suitable investment objectives for a trust, the trustee will need to consider such trust-specific matters as the purpose of the trust, its

duration, the needs of the beneficiaries and so on. Once investment objectives have been determined, devising an optimal strategy for pursuing them generally will require consideration of such matters as the possible effect of inflation on the value of trust assets, the income flow or capital appreciation expected from different types of investment, the impact of taxation, and the importance of diversification. In short, there *are* certain matters that trustees generally ought to consider in order to give themselves the best possible opportunity to establish appropriate investment objectives and to develop an optimal strategy for pursuing those objectives. This provides a reason for requiring trustees to consider such matters in planning the investment of trust property.

[158] Before considering whether there are cogent objections to requiring trustees to consider certain matters when planning the investment of trust property, we pause to make a couple of points about how the requirement, if there is one, should operate. The first point relates to the context in which trustees would be required to consider the matters mentioned in the list. One possibility is that trustees would be required to consider the matters every time they make an investment decision. The other possibility is that they would be required to consider the specified matters when developing a general plan or strategy for investing. Having established an investment plan or strategy, trustees would not necessarily be required to consider the specified matters each time they have to make a decision about the investment of trust property.

[159] We believe that if trustees are required to consider certain matters, it should be a requirement that expressly applies only to the investment planning stage. It should not be worded so as to necessarily require trustees to consider each matter every time they propose to make an investment. For example, take a requirement to consider the possible effect of inflation. The possible effect of inflation is certainly a highly relevant consideration for a trustee who is developing a strategy for investing the funds of a trust that is expected to last for many years. Suppose that as a result of the trustee's reflections about potential inflation and other relevant matters, the trustee decides to allocate 65% of the trust's assets to equities, 25% to bonds and 10% to money market instruments. With such a portfolio, the trustee will likely receive a steady stream of income in the form of dividends and interest. Assuming that some or all of this income is to be reinvested (rather than paid over to beneficiaries), we do not think the trustee should be required to reconsider the

possible effect of inflation (or the other matters in the list) each time it makes an investment decision. It should suffice that the trustee makes ongoing investment decisions in accordance with a strategy that takes account of inflation and the other matters in the list.

[160] The second point we want to make about the operation of a mandatory list of matters to be considered by trustees is this. When we say trustees would be required to consider the matters mentioned in the list, we mean that they would be required to consider each of the matters to the extent that it is relevant to the circumstances of the trust. This is a point that the UPIA is careful to make:

> Among circumstances that a trustee shall consider . . . are such of the following as are relevant to the trust or its beneficiaries.[140]

It is also made by the Australian statutes:

> . . . a trustee shall, so far as they are appropriate to the circumstances of the trust, have regard to . . .[141]

In contrast, Ontario and Saskatchewan have simply modified the UTIA's permissive wording to make it mandatory:

> A trustee must consider the following criteria in planning the investment of trust property, in addition to any others that are relevant to the circumstances.[142]

The Ontario and Saskatchewan wording seems to suggest that the trustee must consider the listed criteria whether they are relevant to the circumstances of the particular trust or not.

[161] We refer again to the common requirement for trustees to consider the possible effect of inflation when deciding how to invest trust property. Certainly, if a trust is expected to last for, say, ten or twenty years or more, the prudent trustee will consider the effect of inflation when planning how to invest trust property. On the other hand, if the trust is likely to last only a few months, there is really no need for the trustee to consider inflation when planning the investment of trust property. In effect, the American UPIA and Australian statutes require trustees first to consider *whether* each specified matter is relevant to the circumstances of

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[140] UPIA s. 2(c).

[141] *Trustee Act, 1962* (WA), s. 20(1).

[142] *Trustee Act*, R.S.O. 1990, c. T.23, s. 27(5), as am. by S.O. 1998 c. 18, Sched. B, s. 16. The wording of the Saskatchewan provision is slightly different, but to the same effect.

the trust. If a particular matter is relevant, then the trustee must consider how to account for it in their investment strategy.

iv. Objections to a Mandatory List

[162] One objection to requiring trustees to consider the matters such as those mentioned in the UTIA's list is that it will not really provide guidance to unsophisticated trustees, while sophisticated trustees will consider such matters whether told to do so or not:

> It is unlikely that less sophisticated trustees would be assisted to any great degree by the inclusion of guidelines such as those listed above, as they will require expert advice in any event in order to assess tax consequences and inflation. More sophisticated trustees will be aware that factors such as those listed in [UTIA section 3(3)] above play a part in every well-considered investment decision.[143]

[163] Certainly, there is no possibility that reading a list of matters to consider, such as those found in the UTIA, will provide an unsophisticated trustee with a magic formula for developing an effective investment plan. Simply telling an unsophisticated trustee to consider the effect of inflation or taxation is not going to provide them with any clue as to *how* to take these matters into account. On the other hand, directing unsophisticated trustees to consider such matters as inflation and taxation should at least impress upon them that developing an effective investment strategy requires a consideration of those matters. If they have no idea how inflation or tax considerations should affect their investment approach, the fact that they have been directed by the statute to consider them should encourage unsophisticated trustees to seek advice from someone who does.

[164] A related objection is that the list of factors may come to be regarded as a mechanical checklist, a substitute for real consideration of the matters that should inform trustee decision-making:

> Over the course of time guidelines may be seen as a checklist that must be gone through in order for an investment decision to be considered prudent in a legal sense. The standard of "prudence" might thus become equivalent to a mechanical process of demonstrating compliance with the checklist rather than a careful analysis of risk and return in light of prevailing conditions.[144]

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[143] BCLI 1999 at 10.

[144] *Ibid.*

In our view, it would not necessarily be a bad thing if the list of matters to be considered came to be regarded by trustees and their advisers as a sort of checklist for investment planning. After all, a checklist is simply a means of reminding someone to perform certain tasks that are critical to attaining a desired objective, whether it be landing an airplane, buying everything you need at the grocery store, or designing an effective investment strategy. Moreover, we think that if a trustee can demonstrate that they have given proper consideration to the matters in a list such as is found in UTIA section 3(3), they will have gone a long way towards demonstrating that they have, in fact, undertaken a "careful analysis of risk and return in light of prevailing conditions."

[165] The final objection to a mandatory list of matters for trustees to consider in planning the investment of trust property is that it will expose trustees to undue "litigation risk." There are two branches to this argument. The first is that the existence of a mandatory list will lead to vexatious litigation against trustees. Beneficiaries who have no real grounds for complaint about the performance of a trust will be encouraged to "take a run" at the trustee in the hope that the trustee will be unable to show how they considered the effect of inflation (or some other matter mentioned in the list) when planning how to invest trust property. The second branch of the argument is that trustees will be in danger of being found liable merely because they cannot show that they considered every matter in the list, even though their actual investment strategy was sound. In our view, these concerns are addressed by the manner in which we recommend that the *Trustee Act* would direct courts to assess trustees' investment conduct.

[166] At this point it is useful to foreshadow the recommendation we are going to make in the succeeding section on trustee liability. In order to fix a trustee with liability for a loss, it will be necessary to do more than show that the trustee has failed to take account of some factor that they should have taken into account. It will be necessary to show that their failure to take account of the factor has led them to take an investment approach that a prudent trustee *would not* have adopted under comparable circumstances. If, for example, a trustee's investment approach was determined without paying any overt attention to the impact of taxation, this could lead to the trustee being held liable for a loss to the trust. But the trustee will only be liable if it is established that their failure to take account of taxation led them to an investment approach that a trustee who did pay due regard to this matter

would not have taken. Given this approach to determining trustee liability, we do not think that a requirement for trustees to consider certain factors will lead either to vexatious "fishing expeditions" against trustees or to inappropriate findings of liability against trustees when they are sued.

v. Recommendation Regarding Mandatory List

[167] It will be evident that we think that the *Trustee Act* should require trustees to consider certain matters when planning the investment of trust property, insofar as they are relevant to the circumstances of the particular trust. Here we consider what matters should be mentioned in the list. One possible approach would be to simply convert the UTIA's permissive list into a mandatory list. However, having studied both the UTIA list (which, it will be recalled, is virtually identical to the list in the US UPIA) and the list found in Australian statutes, we think it would be beneficial to borrow certain ideas from the latter.

RECOMMENDATION No. 6

Without restricting the matters that a trustee may consider, a trustee should be required to consider the following matters in planning the investment of trust property, insofar as their consideration is consistent with the terms and relevant to the circumstances of the trust:

(a) the purposes and probable duration of the trust, the total value of the trust's assets, and the needs and circumstances of the beneficiaries;

(b) the duty to act impartially towards beneficiaries and between different classes of beneficiaries;

(c) the special relationship or value of an asset to the purposes of the trust or to one or more of the beneficiaries;

(d) the possible effect of inflation or deflation;

(e) the need to maintain the real value of the capital or income of the trust;

(f) the need to maintain within the portfolio a balance that is appropriate to the circumstances of the trust between
- **risk,**
- **expected total return from income and the appreciation of capital,**
- **liquidity, and**
- **regularity of income;**

(g) the importance of diversifying the portfolio to an extent that is appropriate to the circumstances of the trust,

(h) the role that different investments or courses of action play within the overall portfolio;

(i) the costs (such as commissions and fees) and expected tax consequences of investment decisions or strategies.

[168] The following paragraphs comment on particular aspects of Recommendation 6. We begin by commenting generally on the structure and introductory part of the recommendation. We then comment briefly on the specific matters that are (and some that are not) included in the list.

[169] *General.* The introductory clause of Recommendation 6 refers to "planning the investment of trust property." This reflects the wording of the UTIA and emphasizes that the trustee would be required to consider the listed matters when establishing a plan for the investment of trust property, but not necessarily each time it makes an investment in accordance with that plan.[145] As previously discussed, the introductory wording follows the approach of the US UPIA and Australian statutes in emphasizing that the trustee is required to consider the listed matters only insofar as their consideration is consistent with the terms and relevant to the circumstances of the trust.

[170] *Structure of the list.* The organization of a list such as appears in Recommendation 6, the UTIA or the Australian statutes will necessarily be somewhat arbitrary. However, we have attempted to arrange Recommendation 6 in

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[145] See para. 159, above.

a manner that has a certain internal logic. We have put at the beginning of the list (clauses (a)-(e)) matters that would be relevant to determining general investment objectives. To emphasize the importance of determining investment objectives in accordance with the circumstances of the trust, the first three clauses emphasize trust-specific matters. Clauses (d) and (e) relate to more general considerations. The items in the latter part of the list (clauses (f)-(i)), are matters that trustees should consider in developing a strategy for pursuing their investment objectives.

[171] *Matters not mentioned in the list.* Our list omits clauses (a) ("general economic conditions") and (f) ("other resources of the beneficiaries") of UTIA section 1(3). The former is deleted because we think that while it does no harm in a permissive list, it is too vague for a mandatory list of matters to be considered. The latter is omitted because it is comprehended by Recommendation 6(a)'s reference to the needs and circumstances of the beneficiaries.

[172] *Clause (a)* reads is as follows:

> the purposes and probable duration of the trust, the total value of the trust's assets, and the needs and circumstances of the beneficiaries;

This clause, which is not found in the UTIA, comes from the Australian statutes. As already mentioned, like clauses (b) and (c), it is intended to emphasize the importance of considering the circumstances of the particular trust. For example, the expected duration of a trust will have a large bearing on the appropriateness of investing in equities, or the relative weight of equities versus debt securities. Thus, an investment strategy heavily weighted towards equities that would be perfectly suited to a long-term trust might be totally inappropriate for a trust projected to last only a few months.

[173] *Clause (b)* reads as follows:

> the duty to act impartially towards beneficiaries and between different classes of beneficiaries;

This is another provision that is not mentioned in the UTIA list. Its absence was noted by Professor Waters in his paper for the MLRC:

> If the Trustee Act is to be a guide in this manner, something should be said of the even hand rule. Since even hand and investment continue to be interrelated, it continues to be the law that a trustee's method of investment must take into account, if that is the case, that successive income and

> capital beneficiaries are looking to the investment process for different results.[146]

The point is that a trustee may have investment constraints beyond the normal "risk-expected return" considerations that would apply to an individual investing for their own account.

[174] The basic issue is introduced in a little more detail in Professor Water's text on the law of trusts:

> But where the trust is in favour of both income and capital beneficiaries, as for instance a widow for life, remainder to children of the marriage, the trustee has to reconcile with his investment plans the contradictory interests of those two types of beneficiary. The tax implications are an added factor. At the back of his mind must always be his fundamental duty as trustee to keep a balance between the interests of those two classes of persons, and therefore to ensure that the results produced by his investment policy, though possibly commendable by other tests, do not prejudice one beneficiary at the expense of another. Only contrary instructions in the trust instrument can authorize his departure from this duty. Prudence in investment, and the holding of an even hand between beneficiaries, are distinct duties, but they are interwoven in practice.[147]

As Professor Waters notes, the duty of impartiality will not apply to every trust. The duty might be (and often is) excluded by the terms of the trust instrument, there might be only one beneficiary, or the interests of all the beneficiaries may be congruent, so far as investment strategies are concerned. The introductory words of Recommendation 6 make it clear that the trustee would only be expected to consider the implications of the "even-hand" rule where it is consistent with the terms and relevant to the circumstances of the trust.[148]

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[146] Waters 1998 at 39.

[147] Waters 1984 at 765-66. This passage is but Professor Waters' introduction to the complexities of the even-hand rule: the rule in all its intricacy is discussed *ibid.* at 787-870.

[148] The Australian statutes do not mention the even hand rule in their list of matters to be considered. However they all contain a provision to the following effect, which is from s. 19 of the Western Australian Act:

> 19.(1)Any rules and principles of law or equity that impose a duty on a trustee exercising a power of investment including, without limiting the generality of those duties, rules and principles that impose —
>
> . . .
>
> (c) a duty to act impartially towards beneficiaries and between different classes of beneficiaries;
>
> . . .
>
> continue to apply except to the extent that they are inconsistent with this or any other Act or the instrument creating the trust.

[175] *Clause (c)* reads as follows:

> the special relationship or value of an asset to the purposes of the trust or to one or more of the beneficiaries.

This corresponds to clause (h) of the UTIA list. This is another matter where the phrase, "insofar as their consideration is consistent with the terms and relevant to the circumstances of the trust," is particularly important. In many trusts, there will be no assets that meet this criterion of "special value." If there is such an asset (e.g. a dependent adult's cottage), its special value or relationship to the purposes of the trust or to a beneficiary should be factored into the trustee's investment decisions. Of course, if a trust creator really wants to ensure that a trustee retains a particular asset "come hell or high water," the trust instrument could include a specific direction to that effect.

[176] *Clause (d)* reads as follows:

> the possible effect of inflation or deflation.

This corresponds to clause (b) of the UTIA list. Consideration of the possible effect of inflation or deflation will almost certainly be relevant for longer term trusts. Inflation will be less of a concern in the context of short-term trusts.

[177] *Clause (e)* reads as follows:

> the need to maintain the real value of the capital or income of the trust

The wording of this clause comes from the New Zealand and Australian statutes, but it serves a similar function to the portion of UTIA clause 1(3)(g) that refers to "preservation or appreciation of capital." The reference to "real" value obviously is intended to draw the trustee's attention to the inflation-adjusted value, so there is some overlap with clause (d). However, a concern to maintain the real value of the trust capital also implies a concern to guard against undue risk of loss or depreciation, as measured in nominal dollars. That is, an investment strategy that involves an undue risk of loss, measured in nominal dollars, necessarily involves an undue risk of loss, measured in real dollars.

[178] Clause (e) refers to "capital or income." To the extent that trust income is generated by trust capital, maintaining the real value of the capital should have the incidental effect of maintaining the real value of the trust income. Nevertheless, it is worthwhile to direct the trustee's attention to maintaining the real value of future income, as well as the real value of capital.

[179] *Clause (f)* reads as follows:

> the need to maintain within the portfolio a balance that is appropriate to the circumstances of the trust between
>
> - risk,
> - expected total return from income and the appreciation of capital,
> - liquidity, and
> - regularity of income. circumstances of the trust

The first five clauses of Recommendation 6 direct trustees to consider what they want to achieve through their investment strategy, given the constraints they have to work with. This consideration will reveal various tensions, the precise nature of which will depend on the circumstances of the trust. Clause (f) is intended to direct trustees' attention to the characteristics of their proposed portfolio, viewed in the light of the circumstances of the trust.

[180] There is an obvious tension between expected return and risk; the trustee must ensure that the overall risk associated with the portfolio is appropriate to the circumstances of the trust. A level of risk that is appropriate to one trust might be inappropriate for another. Similarly, the financial needs of an income beneficiary might argue in favour of a greater focus on securities that produce regular, predictable flows of income (e.g. debt instruments or certain preferred shares) than would be justified if the trustee was concerned only with total expected return and risk. If there is a likelihood that the trustee will need to disburse funds to beneficiaries at unpredictable times, this could demand a greater emphasis on liquidity within the portfolio than would be warranted if the income demands were more predictable.

[181] *Clause (g)* reads as follows:

> the importance of diversifying the portfolio to an extent that is appropriate to the circumstances of the trust.

It will be recalled that the UTIA's list of matters to be considered is permissive, while we propose a mandatory list. The UTIA, on the other hand, contains a separate section that specifically requires diversification of the trust's investments:

> 03 A trustee must diversify the investment of trust property to an extent that is appropriate having regard to
>
> (a) the requirements of the trust, and
>
> (b) general economic and investment market conditions.

Clause (g) is similar in effect to UTIA section 3. Rather than requiring diversification, however, a provision based on this clause would direct the trustee

to consider the importance of diversifying the trust portfolio to an extent that is appropriate to the circumstances of the trust.

[182] The wording of clause (g) is similar to the wording of section 6(1) of the UK *Trustee Investments Act 1961*, which provides that a trustee exercising investment powers shall have regard to, amongst other things, "the need for diversification of investments of the trust, in so far as is appropriate to the circumstances of the trust." In *Cowan v. Scargill* Megarry V-C made the following observation regarding this provision:

> The reference to the 'circumstances of the trust' plainly includes matters such as the size of the trust funds: the degree of diversification that is practicable and desirable for a large fund may plainly be impracticable or undesirable (or both) in the case of a small fund.[149]

Another matter that would affect the emphasis on diversification is the duration of the trust. If a trust is expected to last only a few weeks or months, putting the whole of the trust fund into treasury bills might well be an optimal investment strategy. In such circumstances, investing any portion of the trust fund in equities in the name of diversification might be regarded as wholly inappropriate because of the short-run volatility of equity markets.

[183] We have mentioned the importance of diversification as one of several matters that a trustee must consider, rather than setting it out in a separate provision as in the UTIA. Nevertheless, we do not mean to diminish the crucial role that diversification will normally play in protecting a trust from undue risk. A trustee who fails to diversify will bear a heavy burden of explanation if their highly concentrated portfolio suffers a loss that would in all likelihood have been avoided or mitigated if the trustee had diversified the portfolio.[150]

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[149] [1984] 2 All E.R. 750 at 762.

[150] The difficulty in which trustees who decide not to diversify may find themselves is illustrated by *Re Janes*, 681 N.E.2d 332 (N.Y.C.A. 1997). The appeal arose out of a lower court's decision to surcharge the trustee for investment losses. At the time of the testator's death, 71% of the market value of the estate's stock portfolio consisted of shares of the Eastman Kodak Company. The professional trustee did not diversify out of the Kodak shares, and by the time it applied to pass its accounts, the shares were worth only about one third of their original value.

The trustee argued that, as a matter of law, its failure to diversify out of Kodak stock could not be regarded as imprudent in the absence of evidence (other than that provided by hindsight) that Kodak stock was a particularly hazardous investment:

> petitioner asserts, the concentration of Kodak stock at issue in this case, that is, of an acknowledged 'blue chip' security popular with investment advisors and many mutual funds, cannot be found an imprudent investment on August 9, 1973 as a matter of

[184] *Clause (h)* reads as follows:

> the role that different investments or courses of action play within the overall portfolio.

This is based on clause (d) of the UTIA list. There is some overlap between this clause and clause (g), since a consideration of the role of different investments within the portfolio is an aspect of diversification. However, this clause emphasizes that diversification involves more than just buying a bunch of different assets. A well thought-out portfolio consisting of 10 securities could be much better diversified than a poorly thought-out portfolio consisting of 100 securities. Clause (h) emphasizes the importance of considering the interrelationship between different investments or courses of action when designing a diversification strategy.

[185] *Clause (i)* reads as follows:

> the costs (such as commissions and fees) and expected tax consequences of investment decisions or strategies.

The portion of clause (i) that refers to the expected tax consequences of investment decisions or strategies is from clause (c) of the UTIA list. The reference to costs of investment strategies is from the Australian statutes. We think it is important to draw trustees' attention to the importance of considering the costs associated with different investment approaches. For example, apart from any other issues created by an investment approach predicated on frequent buying and selling of stock in an attempt to "time the market," such an approach will entail high brokerage commissions relative to a "buy and hold" investment strategy.[151]

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law.–*ibid* at 336.

The Court (which technically was applying New York's version of the prudent man rule, as opposed to the newly enacted prudent investor rule) held that it was an issue not of law but of fact whether a trustee's failure to diversify constitutes imprudence:

> . . . the very nature of the prudent person standard dictates against any absolute rule that a fiduciary's failure to diversify, in and of itself, constitutes imprudence, as well as against a rule invariably immunizing a fiduciary from its failure to diversify in the absence of some selective list of elements of hazard, such as those identified by petitioner. . . The inquiry is simply whether, under all the facts and circumstances of the particular case, the fiduciary violated the prudent person standard in maintaining a concentration of a particular stock in the estate's portfolio of investments.–*ibid.* at 337.

Having determined that the issue was one of fact, the Court held that there was evidence on the record to support the lower court's determination that the trustee's failure to diversify was imprudent.

[151] Similarly, if the trustee is purchasing mutual fund units rather than (or in addition to) investing directly in stocks, "actively managed" funds may have considerably higher expense ratios than funds that employ passive investment strategies.

3. Trustee Liability for Improper Investment Decisions

[186] This section is concerned with the liability of a trustee for losses caused by failure of the trustee to conform to the standards of prudent investment. There are a couple of questions that may need to be asked in this context. The first is whether the trustee's investment conduct meets the standards of prudent investment. If it does, that is the end of the enquiry. If the trustee has invested in accordance with prudent investment standards, there can be no liability, even if the trust has suffered a loss. But if it is determined that the trustee has invested in an imprudent manner, the next question is what is the measure of the loss, if any, that is attributable to the trustee's imprudence.

a. Does the Trustee's Conduct Meet the Standard of Prudence?

[187] The prudent investor standard does not provide the trustee with a mechanistic procedure that leads to a unique, optimal investment strategy for investing trust property. Rather, it describes in general terms how trustees should go about the task of determining and pursuing investment objectives. Different trustees faced with identical circumstances might well establish somewhat different investment objectives. And even if two trustees happen to be pursuing identical investment objectives in identical circumstances, the makeup of and the actual returns from their respective portfolios will in all likelihood differ to some degree.

[188] Whatever investment strategy a trustee has followed, it will be possible, with the benefit of hindsight, to identify a prudent investment strategy that would have produced higher returns than were actually realized. Obviously, it would be illogical to infer that a trustee has failed to follow the standards of prudent investment simply because it is possible to identify prudent investment strategies that would have produced higher returns than were actually realized. Therefore, where a trustee's investment conduct is called into question, the appropriate question is *not* whether another trustee applying the standards of prudent investment could have realized higher returns than were actually realized. The question should be whether a reasonably skilled and prudent trustee applying the standards of prudent investment in the circumstances actually faced by the trustee *could* have invested in the manner that the trustee actually invested. This is one of the thrusts of section 4 of the UTIA:

> **04.** A trustee is not liable for a loss to the trust arising from the investment of trust property if the conduct of the trustee that led to the loss conformed to a plan or strategy for the investment of the trust property, comprising reasonable assessments of risk and return, that a prudent investor could adopt under comparable circumstances.

[189] We said that one of the thrusts of UTIA section 4 is to emphasize that the issue is whether a prudent investor *could* have adopted the investment strategy that the trustee actually adopted. The ULCC's own commentary on section 4 emphasizes the section's relationship to the portfolio perspective that underlies the prudent investor rule:

> Section 04 draws on s. 79 of Manitoba's Trustee Act and s. 2(b) of the [UPIA], both of which require that trustees' investment decisions be evaluated not in isolation, but in a portfolio context. It is intended to prevent trustees whose overall investment activity and strategy are sound from being held in breach of trust merely because individual investment decisions may appear to have been imprudent when viewed in isolation with the benefit of hindsight.

It may be observed that the idea that conduct of the trustee is to be evaluated from the portfolio perspective is implicit rather than explicit in UTIA section 4.

[190] The necessity of evaluating the trustee's particular investment decisions in the context of the whole portfolio is expressed explicitly in UPIA section 2(b):

> (b) A trustee's investment and management decisions respecting individual assets must be evaluated not in isolation but in the context of the trust portfolio as a whole and as a part of an investment strategy having risk and return objectives reasonably suited to the trust.

The word "portfolio" does not appear in UTIA section 4. The latter's reference to a plan or strategy for the investment of trust property comprising reasonable assessments of risk and return carries the burden of importing the portfolio perspective into the evaluation of the trustee's conduct.

[191] We are in full agreement with the objective of UTIA section 4. However, we would frame the statutory provision in somewhat different terms than UTIA section 4. We will set out our recommendation and then explain why we have chosen to frame it as we have, rather than simply adopting the wording of UTIA section 4.

RECOMMENDATION No. 7

The *Trustee Act* should provide that a trustee is not liable for a loss in connection with the investment of trust property if the loss arises from a decision or course of action that a reasonably skilled and prudent trustee acting in accordance with Recommendations 5 and 6 might have made or adopted.

[192] The first point of departure of the foregoing recommendation from UTIA section 4 relates to the latter's reference to a plan or strategy "that a prudent investor could adopt under comparable circumstances." As noted above, the UTIA's reference to a prudent investor is intended to import by implication the idea that a prudent investor would have followed the portfolio approach. Instead of leaving this to implication, our recommendation refers to what a reasonably skilled and prudent trustee[152] acting in accordance with Recommendations 5 and 6 might have done.

[193] A trustee acting in accordance with those Recommendations 5 and 6 would have established investment objectives with a view to obtaining a reasonable return while avoiding undue risk, in light of the circumstances of the trust. This trustee would have assessed risk and expected return in the context of the overall trust portfolio. This trustee would have considered the relevant matters mentioned in Recommendation 6 when investing the trust property. In short, Recommendation 7's reference to what a reasonably skilled and prudent trustee acting in accordance with Recommendation 5 and 6 might have done serves the same purpose as UTIA section 4's reference to what a prudent investor could have done in comparable circumstances.

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[152] The reference to a "reasonably skilled and prudent" trustee goes back to a point that we mentioned earlier in relation to Recommendation 5. Both Recommendation 5 and Recommendation 6 direct the trustee to do certain things, such as to invest trust property with a view to obtaining a reasonable return while avoiding undue risk, having regard to the circumstances of the trust. Those recommendations do not speak to the standard by which the trustee's efforts to comply with these directions are to be measured. The reference to a trustee of reasonable skill and prudence in Recommendation 7 is intended to evoke judicial characterizations of the objective standard by which trustee performance is to be measured. For example, in *Fales v. Canada Permanent Trust* [1977] 2 S.C.R. 302 at 316: "But however wide the discretionary powers contained in the will, a trustee's primary duty is preservation of the trust assets, and the enlargement of recognized powers does not relieve him of the duty of using *ordinary skill and prudence*, nor from the application of common sense." [emphasis added]

[194] We considered framing Recommendation 7 so as to refer to a loss arising from conduct that *conformed to a plan or strategy* that a reasonably skilled and prudent trustee could have adopted. However, we ultimately decided to refer to a loss arising from a *decision or course of action* that a reasonably skilled and prudent trustee could have made or adopted. Our rationale is that UTIA section 4's reference to conformity to a plan or strategy could raise interesting but unnecessary questions about how comprehensive or detailed a plan or strategy needs to be in order to provide a foundation for the "conformity" defence.[153] We believe that referring to a loss arising from a decision or course of action that a reasonably skilled and prudent trustee could have made or adopted focuses the enquiry on the appropriate issue. Could a reasonably skilled and prudent trustee who acted in accordance with Recommendations 5 and 6 have made the decision or adopted the course of action that has led to the loss in question?

[195] It is worth emphasizing a point that was alluded to earlier concerning the relationship between Recommendations 6 and 7. Suppose that a course of action taken by a trustee has allegedly resulted in a loss to the trust, for which the beneficiaries are seeking to have the trustee held liable. The beneficiaries allege that a loss has been suffered because in planning the investment of trust property, the trustee failed to consider one of the matters mentioned in a legislative provision based on Recommendation 6: let us say, the expected tax consequences of an investment decision.

[196] In defending the action, it would undoubtedly be to the trustee's advantage to be able to establish that it overtly considered expected tax consequences when planning the investment of trust property. But whether the trustee did or did not consider tax consequences is *not* the crucial issue. The crucial issue, given a legislative provision based on Recommendation 7, is whether a reasonably skilled and prudent trustee who considered the tax consequences *could* have adopted the

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[153] For example, suppose that a trustee reasonably decides to allocate the trust's assets on a 60:30:10 basis between equities, long-term bonds and money market instruments. Having established this reasonable asset allocation plan, the trustee implements it by investing 60% of the trust's assets in common shares of a single company: the South Sea Internet Co. The company goes bankrupt shortly thereafter and the whole investment is lost. Could the trustee argue that it is not liable for the loss because its investment conformed to a plan or strategy for the investment of trust property that a reasonably skilled and prudent trustee could have adopted? The probable answer of a court would be that, for the purposes of the "conformity" defence, the trustee did not have a plan; it had the beginnings of the plan. However, we think it is preferable to avoid the need for this sort of enquiry.

investment plan or strategy that this trustee has in fact followed. It would be possible for a court to reach an affirmative answer to this question without being convinced that this trustee actually considered the tax consequences.[154] On the other hand, it will not avail the trustee to demonstrate that it considered the tax consequences if the court is convinced that no reasonably skilled and prudent trustee who considered the tax consequences would have followed the course of action that led to the loss.[155]

b. Identifying and Quantifying the Loss

[197] If it is established in a lawsuit that the conduct of a trustee fell below the prudent investor standard, it will be necessary to determine what loss, if any, has been suffered by the trust as a result of trustee's imprudence. This issue is partially addressed by UTIA section 5, which reads as follows:

> **05. A court assessing the damages payable by a trustee for a loss to the trust arising from the investment of trust property may take into account the overall performance of the investments.**

The ULCC's commentary on section 5 indicates that its purpose is to abrogate the "much criticized 'anti-netting' rule," which does not allow the netting of gains against losses.

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[154] A legislative provision based on Recommendation 7 would not be a departure from the principles upon which courts of equity evaluate trustee's conduct. As Megarry V-C put it in *Cowan v. Scargill* [1984] 2 All E.R. 750 at 766:

> If trustees make a decision on wholly wrong grounds, and yet it subsequently appears, from matters which they did not express or refer to, that there are in fact good and sufficient reasons for supporting their decision, then I do not think that they would incur any liability for having decided the matter on erroneous grounds; for the decision itself was right.

In the case before him, Megarry V-C actually concluded that the defendant trustees were not only basing their decisions on wholly wrong grounds, but that their decisions were wrong. However, the dictum of Megarry V-C was applied in the trustee's favour in a subsequent decision of the English Court of Appeal: *Nestle v. National Westminster Bank* [1994] 1 All E.R. 118. In this case it was established that the trustee (a bank) had failed to understand the breadth of its investment powers under the trust instrument and had failed to conduct periodic reviews of the trust portfolio for a period of some forty years: *ibid.*, at 124-25, 133. There was "not much for the bank to be proud of in its administration of the Nestle trusts." Nevertheless, it was not established that the bank's misunderstanding of its investment powers or its failure to regularly review the portfolio had caused it to invest in a manner that caused the trust to suffer a loss.

[155] But it might well be of assistance if the trustee applies for discretionary relief under section 41 of the *Trustee Act*. As discussed earlier, courts are more inclined to take subjective considerations into account when deciding whether to grant relief under section 41 for a breach of trust than when determining whether there as been a breach of trust in the first place.

[198] The anti-netting rule is easy to explain in the context of the legal list approach, with its dichotomy between authorized and unauthorized investments. Suppose that a trustee invests $1,000 in each of two unauthorized investments. The trustee realizes a gain of $1000 on one of the investments but suffers a loss of $500 on the other. The net result to the trust is a gain of $500 on the $2000 that was invested in the two unauthorized investments. However, under the anti-netting rule traditionally applied by the courts, no allowance would be made in the trustee's favour for the unauthorized investment that realized a gain for the trust. The trustee would be liable to the trust for the $500 loss, without allowance for the $1000 gain realized on the other unauthorized investment.[156]

[199] In our view, once it has been determined that a trustee's investment conduct falls below the required standard, the proper approach to quantifying damages is the same approach that the courts generally take to assessing damages. The objective is to quantify, with as much confidence as is possible, the loss that has been suffered by the trust as a result of the trustee's imprudence. What is the difference between the actual value of the trust's assets and the value it appears that they would have had if the trustee's investment conduct had met the appropriate standard? Given this objective, whether it is appropriate to "take into account the overall performance of the investments" in assessing damages will depend on the circumstances. More precisely, perhaps, it depends on how one defines "the investments" whose performance is to be taken into account.

[200] Consider, on the one hand, a situation where the trustee's imprudence consists of failing to adopt an appropriate investment plan or strategy. Suppose that the trustee decides to invest all of the trust property in internet stocks. Without knowing anything about how the portfolio of internet stocks actually performs, we can conclude that, in the absence of very special circumstances, the trustee is probably investing imprudently. The trustee appears to have failed to pay proper (or any) attention to the importance of diversification as a means of avoiding undue risk.

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[156] For a recent Canadian application of the anti-netting rule, see *Sharpe v. McCarthy* (1994), 94 B.C.L.R. (2d) 384 (C.A.). In this case, an employee of a brokerage firm had engaged in unauthorized trading, resulting in substantial losses to the plaintiff. Some of the unauthorized transactions had in fact resulted in profits. The Court of Appeal upheld the trial judge's conclusion that the brokerage firm was not entitled to set off the profits realized on the successful transactions against the losses on the unsuccessful transactions.

[201] But the trustee's imprudence lies in its decision to invest only in internet stocks, rather than in particular decisions that it makes in allocating the trust funds between different internet stocks. Therefore, in assessing whether the trust has suffered any loss as a result of the trustee's imprudence, and in quantifying the loss if there is one, the focus of enquiry should be on the overall outcome of the trustee's strategy of investing only in internet stocks. The logical way to evaluate the outcome of this faulty strategy is to compare the actual return from the trustee's portfolio of internet stocks to the return that could have been realized from a prudent investment strategy.[157] This necessarily involves netting gains on "winners" within the trustee's actual portfolio against the losses on the "losers."

[202] Now consider a situation where the trustee has been imprudent in a particular investment decision, and that decision has caused the trust to suffer a loss. To take a particularly stark, if (hopefully) unlikely example, suppose that a trustee decides to diversify the trust portfolio in the following manner: 50% equities; 20% bonds; 20% money market instruments; 10% lottery tickets.[158] Here the imprudent conduct is investing 10% (or any) of the trust fund in lottery tickets; nobody has any quarrel with how the other 90% of the trust fund was invested. In assessing damages arising from the imprudent conduct, it would be *inappropriate* to net gains from the 90% of the portfolio that was properly invested against the losses from the 10% "invested" in lottery tickets. The question is, What loss has been caused by the imprudent conduct? The imprudent conduct is not the overall strategy, but the decision to invest some trust property in lottery tickets. Therefore, the proper approach to assessing loss is to compare the actual return from the trust

[157] Of course, there would be many different portfolios that could have been assembled through a prudent investment strategy. So the court would not be able to say that if the trustee had followed a prudent investment strategy, the trust portfolio *would* have consisted of assets A_1, A_2, A_3, . . . A_n, whose aggregate value *would* be $Y. However, with the assistance of expert evidence, the court should be able to conclude that, given the circumstances of the trust, a reasonably skilled and prudent trustee probably would have assembled a portfolio whose current value would lie somewhere within the range between $X and $Z. In the absence of any more precise way to define the value of the hypothetical prudent portfolio, the court might then determine that the value of this portfolio is the average of $X and $Z.

[158] Although the prudent investor rule does not have a concept of investments that are unauthorized *per se*, it is difficult to conceive of circumstances in which a reasonably skilled and prudent trustee would purchase lottery tickets with trust funds. It is not just that lottery tickets are risky investments. The problem is that the economics of (profitable) lotteries are such that the expected return to the purchaser of a lottery ticket, or any number of lottery tickets is *negative*. Given an expectation of negative returns from a purchase of lottery tickets, such a purchase cannot even be dignified by the appellation, "investment."

money improperly invested in lottery tickets to a return that might reasonably have been expected if the money so invested had been invested prudently.[159]

[203] We return now to section 5 of the UTIA. Given what we have said above, we think it is significant that it says that a court "*may* take into account the overall performance of the investments," rather than saying that the court *shall* do so. The extent to which the court should take into account the overall performance of the investments will depend on the particular circumstances.

RECOMMENDATION No. 8
The Trustee Act should provide that in assessing damages payable by a trustee for a loss to the trust arising from the trustee's failure to conform to the standard of prudent investment, a court *may* take into account the overall performance of the investments.

4. Investment Advice

[204] It may strike many readers as obvious that in most circumstances the prudent course of action for a trustee who is not particularly knowledgeable about investment matters is to obtain advice from someone who is. Therefore, it may strike many readers as odd that the ULCC found it necessary to include UTIA section 6:

> **6**(1)A trustee may obtain advice in relation to the investment of trust property.
>
> (2)It is not a breach of trust for a trustee to rely upon advice obtained under subsection (1) if a prudent investor would rely upon the advice under comparable circumstances.

[205] Could there be any doubt, UTIA section 6 aside, that a trustee may obtain investment advice and rely upon it if a prudent investor would do so? The answer of the ULCC's Commentary on section 6 is that there could be and is some doubt:

[159] As mentioned above, it will be easier to establish the actual value of the imprudent "investment" in lottery tickets (or in any other actual, imprudent investment) than to determine the value the funds so invested might reasonably have been expected to have if they had been invested prudently. The latter task will involve some informed speculation by the court. In this example, a logical approach would be to ask what the total value of the portfolio would have been if the 10% of the fund used to purchase lottery tickets had instead been invested in the same manner as the other 90% of the portfolio.

> Like other investors, individual trustees often require advice in order to maximize the return from trust property while holding risk to a tolerable level. General trust law assumes, however, that trustees will exercise their own judgment and discretion. Their ability to seek and rely upon investment advice without an express power to do so is in some doubt.

[206] Other commentators and law reform bodies, however, have questioned whether a provision along the lines of UTIA section 6 serves any purpose. Professor Waters, in a paper for the MLRC, suggests that there is no doubt that trustees can seek and rely upon expert investment advice.[160] Nevertheless, he argues that the UTIA provision is useful insofar as it stipulates that the trustee is entitled to rely on the advice *only* if a prudent investor would do so in comparable circumstances:

> In many trust instruments today a clause is introduced excusing trustees from any liability if they have relied upon advice received from a professional. This language is understood to have the effect of exempting them from liability even if the advice is subsequently held by a court to be that which a trustee should not have relied upon. Trustees not unnaturally take the position that if they have sought advice for a fee from a reputable source, they should not be held liable if it is subsequently established that that advice, especially legal advice, was incorrect. Section 06(2) [of the UTIA] nevertheless takes the position that trustees may only rely if a prudent investor would have relied upon the advice obtained. That is important. It reintroduces the prudence that must underlie all trustee conduct. The trustees are not expected to 'second guess' professionals, but they are expected to recognize the advice that–for instance–is thin, poorly reasoned, or lacking in any apparent support.[161]

[207] In its recent report, the MLRC reiterates Professor Waters conclusion about the lack of any doubt that trustees can obtain investment advice.[162] However, unlike Professor Waters, the Commission takes the view that section 6(2) of the UTIA is unnecessary, insofar as it requires trustees to exercise prudence in dealing with the advice they have received:

> Nor does the existing law permit trustees to rely upon advice; the prudence they must demonstrate in the selection of agents is complemented by the prudence they must exhibit in assessing whether they should adopt or not follow the advice they have received. Subsections 06(1) and (2) state the present case law.[163]

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[160] Waters 1998 at 42.

[161] *Ibid.* at 42-43.

[162] MLRC 1999 at 19-20.

[163] *Ibid.* at 20.

The implication is that the MLRC believes that UTIA section 6 serves no purpose.

[208] Even if a provision along the lines of UTIA section 6 might not be particularly useful, it might be included in the *Trustee Act* on the basis that it "can't do any harm and might do some good." But is it clear that a provision along the lines of section 6 could do no harm? A possibility that has occurred to us is that a provision along the lines of UTIA section 6, with its statement that a trustee *may* obtain investment advice, might be taken to indicate a legislative intent that a trustee is never under a *duty* to obtain investment advice. Such an implication, in our view, would be unfortunate.

[209] Other law reform bodies have considered whether the *Trustee Act* should contain a provision *requiring* certain trustees to obtain investment advice. In its consultation paper on trustee investments, the BCLI made the following observations:

> The question whether the *Trustee Act* should impose a duty on non-professional trustees to obtain investment advice is more difficult. Such a change has been recommended in some other parts of the world, including some Canadian provinces. Yet the matter of qualifications for investment counsellors is highly unsettled. It may also be unrealistic to require the cost of obtaining investment advice to be borne by smaller trust funds.
>
> On balance, the Committee thinks that trustees should be required to obtain advice from an objective source before embarking on a course of investment decisions. In the absence of an established system of qualifications for investment counsellors, the most practical way of determining what sources of advice are appropriate seems to be to turn to the "prudent investor" standard. If a prudent investor would rely upon a source of advice, then it should be considered proper for a trustee, who is bound to act as a prudent investor, to rely on it also.
>
> With respect to investment advice, the Committee's proposal then is:
>
> 2. Trustees, other than corporate trustees and other trustees engaged in the business of providing trusteeship services on a commercial fee basis, should be required by the Trustee Act to obtain investment advice from an objective and qualified source before investing trust property. A qualified source is one that would be relied upon by a prudent investor investing his or her own property.[164]

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[164] BCLI 1998 at 7-8.

[210] The BCLI's final report[165] does not contain a recommendation along the lines of the proposal in its consultation document. The report does not discuss the issue of a statutory requirement to obtain investment advice, so the considerations that led the Institute to abandon the proposal are not disclosed.

[211] In its recent report the MLRC advanced a proposal for a statutory provision that would not require any particular class of trustee to obtain investment advice, but which would require every trustee to *consider* whether they should get such advice. After stating why it thinks that a provision along the lines of UTIA section 6 is unnecessary,[166] the report continues:

> In the Commission's opinion, the issue on the subject of investment advice is not whether advice can be obtained, but how stress can be placed by *The Trustee Act* upon the importance of advice in appropriate circumstances.
>
> In many circumstances the seeking of advice will be vital, while in others it is unnecessary (e.g., the trustee is corporate and has access to in-house skilled investment advice) or the cost of obtaining advice is not justifiable (e.g., the trust is small and payments to the beneficiary are frequent and significant).
>
> The Commission is of the view that the trustee should be under a statutory duty to consider, in the particular circumstances, whether advice should be taken.[167]

[212] The New Zealand and Australian statutes do not contain an express requirement to obtain investment advice. Instead, they contain a provision that preserves rules of law or equity that impose a duty on trustees exercising investment powers, except to the extent that the rules are actually inconsistent with the statute or the trust instrument. The statutes give specific examples of rules of law or equity that are thus preserved, including "a duty to take advice."[168] In *Jones v. AMP Perpetual Trustee Company*[169] it was observed that the relevant provision

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[165] BCLI 1999.

[166] See above, para. 207.

[167] MLRC 1999 at 20. The Commission's formal recommendation is that the Act should "provide that the trustees have a duty to consider whether in the particular circumstances they should obtain advice as to the investment of the trust property."

[168] This is clause (d) of subsection 19(1) of the Western Australian statute. The opening and closing words of this subsection, as well as clause (c), are set out in note 131, above.

[169] [1994] 1 N.Z.L.R. 690 at 706.

in the New Zealand act is "in apparent recognition" of the judgment of Megarry V-C in *Cowan v. Scargill*.[170]

[213] The latter case, which has been mentioned earlier in this chapter, arose out of the refusal of union-nominated trustees of a pension scheme for UK coal miners to approve investments in industries that competed with the coal industry or in overseas companies. In holding that the trustees were acting on the basis of improper considerations, Megarry V-C made the following observation regarding the general duty of prudence and a possible corollary duty to obtain advice:

> Fourth, the standard required of a trustee in exercising his powers of investment is that he must–
>
> > take such care as an ordinary prudent man would take if he were minded to make an investment for the benefit of other people for whom he felt morally bound to provide.[171]
>
> . . . That duty includes the duty to seek advice on matters which the trustee does not understand, such as the making of investments, and on receiving that advice to act with the same degree of prudence. This requirement is not discharged merely by showing that the trustee has acted in good faith and with sincerity. . . Accordingly although a trustee who takes advice on investments is not bound to accept and act on that advice, he is not entitled to reject it merely because he sincerely disagrees with it, unless in addition to being sincere he is acting as an ordinary prudent man would act.[172]

[214] The observation of Megarry V-C regarding the trustee's duty "to seek advice on matters which the trustee does not understand" actually came to the aid of the trustee in the *AMP* case. Here the trustee was in fact a trust company, but it had delegated the management of the trust fund (its own employee superannuation scheme) to a related company. Thomas J. held that not only was it proper for the trust company to get investment advice, it would have been inappropriate for it not to do so:

> Perpetual operated as a trust company rather than as a fund manager. It would have been inappropriate for it not to seek expert advice in respect of the superannuation fund in equities. This was not the area of its expertise.[173]

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[170] [1984] 2 All E.R. 750.

[171] This formulation of the duty comes from the Court of Appeal's judgment in *Whitely v. Learoyd* (1886), 33 Ch.. D. 347 at 355 (per Lindley L.J.).

[172] [1984] 2 All E.R. 750 at 762.

[173] *Jones v. AMP Perpetual Trustee Company* [1994] 1 N.Z.L.R. 690 at 708. The passage from *Cowan* in which Megarry V-C refers to the duty to obtain advice is quoted at 706.

[215] Our preference is to leave the matter of whether a particular trustee should be required to get investment advice to the flexibility of the common law. We take this position although we are not aware of any Canadian case that has specifically held that the trustee's overriding duty to act prudently could in some circumstances entail a duty to obtain investment advice.[174]

[216] It is only a matter of common sense that a prudent trustee who is not knowledgeable about investment matters would seek out competent advice with respect to the investment of trust property. We have little doubt that, if confronted squarely with the issue, Canadian courts would hold that the duty of prudence includes a duty to obtain investment advice in appropriate circumstances. We would *not* recommend inclusion of a provision along the lines of UTIA section 6 in the *Trustee Act*. As mentioned above, our concern would be that the inclusion of a provision saying that trustees *may* obtain and rely on investment advice might be taken as expressing a legislative intention that trustees are never *required* to obtain such advice.

5. Delegation of Investment Authority

[217] Traditional trust law draws a distinction between a trustee's employing an agent to carry out investment decisions that have been made by the trustee and a trustee's delegation of the decision-making function to an agent. The former is permitted, the latter is not, at least if the decision can be characterized as one of investment policy:

> The rule which emerges from the authorities seems to be this: whenever the power, discretion or duty assigned to the trustee requires that a policy decision be made, the trustee must make it himself. A policy decision is one which . . . if administrative [e.g. regarding investment of trust funds] . . . directly affects the likelihood of the trust's object or purpose being achieved.[175]

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[174] See, however, *Re Miller Estate* (1987), 26 E.T.R. 188 (Ont. Surr. Ct.), where the issue was whether the fees paid for professional investment advice should come out of the estate or should be deducted from the executors' compensation. In concluding that the fees should be paid out of the estate, the Court made the following observation at 191-92: "In the circumstances of this estate, and especially where the executors are not limited to investments authorized for trustees, the executors might well be criticized for not obtaining investment advice." It would have been but a short step from criticism to liability if the executors had proceeded without investment advice and the estate had suffered a loss.

[175] Waters 1984 at 707.

For example, a distinction might be drawn between (1) directing a broker to buy shares of a certain company at a certain price, and giving the broker authority to do everything necessary to execute those instructions, and (2) giving a broker the authority to decide what shares should be purchased on behalf of the trust.

[218] Another distinction that is drawn is between (1) receiving and giving serious consideration to expert advice in arriving at an investment decision and (2) abdicating responsibility for making investment decisions to experts. This distinction was referred to in an Ontario case in which it was held that a trustee may not invest in mutual funds unless specifically authorized to do so by the trust instrument:

> The purchase of mutual funds as an investment, even if the mutual fund is restricted only to investments permitted under the Trustee Act, is an abdication of responsibility. It is delegating the function of making investment decisions because the trustee is no longer "free to follow or reject the advice of investment counsel". Accordingly, even if the mutual fund is restricted to investments permitted under the Trustee Act, the investment in mutual funds is not a permitted investment under the Trustee Act.[176]

The reference to the trustee not being free to follow or reject the investment advice is made to contrast investment in a mutual fund with the facts and rationale of a case where it had been held that it was appropriate for an executor to retain investment counsel.[177]

[219] The traditional abhorrence of delegation of decision-making authority by trustees conflicts with the complicated realities of a modern-day trustee's investment responsibilities. A trust's beneficiaries may be better served if the unsophisticated trustee delegates day-to-day investment decisions to expert agents, rather than obtaining expert advice but then personally making all the investment decisions on the basis of that advice. A more realistic role for the average trustee is to exercise care in the selection of expert agents, to establish the objectives to which the agent's day-to-day investment activities should be directed, and to monitor the agent's activities with a view to ensuring that they are in accordance with the instructions the trustee has given to the agent.

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[176] *Haslam v. Haslam* (1994), 114 D.L.R. (4th) 562 at 569.

[177] *Re Miller Estate* (1987), 26 E.T.R. 188. As mentioned in note 157, the actual issue in *Miller* was whether the investment counsel's fee should come out of the estate or out of the executor's compensation. There was no issue as to whether it was appropriate to hire investment counsel.

[220] The UTIA deals with the matter of delegation of investment authority in section 7. Subsection 7(1) contains a broad definition of the term "agent." Subsections 7(2) and 7(3) deal respectively with the nature of the investment authority that a trustee may delegate to an agent and the trustee's residual responsibility with respect to selection, instruction and monitoring of the agent. Subsection 7(6) makes the familiar point that the statutory default rule is trumped by a contrary intention expressed in the trust instrument:

> (2) A trustee may delegate to an agent the degree of authority with respect to the investment of trust property that a prudent investor might delegate in accordance with ordinary business practice.
>
> (3) A trustee who delegates authority under subsection (2) must exercise prudence in
>
> (a) selecting the agent,
>
> (b) establishing the terms of the authority delegated, and
>
> (c) monitoring the performance of the agent to ensure compliance with the terms of the delegation.
>
> (6) This section does not authorize a trustee to delegate authority under circumstances in which the trust requires the trustee to act personally.

[221] In discussions of these provisions by the Project Committee, persons who responded to our consultation memorandum and the Institute's Board, no objection was taken to their substance. Such debate as there was focussed on fairly minor issues of wording. Ultimately, with one minor exception mentioned below, we were not convinced that any change we might propose to the wording of subsections (2) or (3) would necessarily be an improvement over the original wording. Therefore, the two recommendations that follow essentially reproduce the wording of UTIA section 7(2) and 7(3), with the qualification at the beginning of Recommendation 9 serving the same purpose as UTIA section 7(6).

RECOMMENDATION No. 9

Subject to a contrary intention expressed in the trust instrument, the Trustee Act should authorize trustees to delegate to agents the degree of authority with respect to investment of trust property that a prudent investor might delegate in accordance with ordinary investment practice.

[222] Recommendation 9 refers to "ordinary *investment* practice" rather than to "ordinary *business* practice" as in UTIA section 7(2). Given that we are concerned with what a prudent investor might do, it seems more appropriate to refer to investment practice than to business practice.

RECOMMENDATION No. 10

The *Trustee Act* should require trustees to exercise prudence in selecting an agent, in establishing the terms of the delegated authority and in monitoring the performance of the agent to ensure compliance with the terms of the delegation.

[223] We now consider two components of UTIA section 7 that have been somewhat controversial in other jurisdictions. Sections 7(4) and 7(5) deal respectively with the duty of the agent to "the trust" and the liability of the trustee for actions of the agent.

> (4) In performing a delegated function, an agent owes a duty to the trust to exercise reasonable care to comply with the terms of the delegation.
>
> (5) A trustee who complies with the requirements of subsection (3) is not liable to the beneficiaries or to the trust for the decisions or actions of the agent to whom the function was delegated.

We will consider section 7(5) first.

[224] The issue addressed by section 7(5) is whether trustees should be vicariously liable for wrongful actions of the agent. The conclusion is that they should not be. Trustees may incur liability for failure to discharge their responsibilities under subsection (3), but if they discharge those responsibilities, they are not vicariously liable for wrongful actions of the agent that cause the trust to suffer a loss.

[225] The controversy in other jurisdictions with respect to UTIA section 7(5) does not seem to be over whether it reflects an appropriate policy–there seems to be general agreement that it does–but over whether it serves a useful purpose, given the existing law. In its recent report, the MLRC expressed the view that section 7(5) "states in principle the present law, as the Uniform Law Conference notes, and the Commission sees no need to put that law into statutory form."[178]

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[178] MLRC 1999 at 23.

[226] We, on the other hand, think it is useful to include a provision based on UTIA section 7(5) in the *Trustee Act*. We do so not so much because it makes it clear that the trustee is not vicariously liable for the agent's wrongful actions, but because it makes it clear that the trustee may incur liability for failing to exercise prudence in regard to the selection, instruction and monitoring of the agent. Although this might indeed already be the position in law, a couple of other provisions of the *Trustee Act* suggest that it would be prudent for the Act to be explicit on this point.

[227] The other provisions of the *Trustee Act* that we have in mind are section 25 and, to a lesser extent, section 23.[179] The relevant portion of the convoluted section 25 reads as follows:

> 25 A trustee is chargeable only for money and securities actually received by him . . . and is answerable and accountable only for his own acts, receipts, neglects or defaults and not for
>
> (a) those of any other trustee,
>
> (b) any banker, broker or other person with whom any trust money or securities may be deposited,
>
> (c) the insufficiency or deficiency of any securities, or
>
> (d) any other loss, unless it happens through his own wilful default
>
> . . .

At one level, section 25 can be regarded as nothing more than a convoluted statutory statement of the common law that trustees are not vicariously liable for an agent's actions. They are liable only for their own negligence ("neglect"), which could include negligence in selection or monitoring of the agent. However, the reference in clause 25(d) to a trustee only being liable for loss that "happens through his own wilful default" has led to uncertainty as to whether a trustee who is merely negligent in selecting, instructing or monitoring an agent might escape liability for the agent's wrongful actions.[180]

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[179] The origins of these provisions and the difficulties of their interpretation are discussed at length in Waters 1984 at 698-710. There is also a helpful discussion of these provision and their interpretation in the UK in LC & SLC 1999 at 157-60 (Appendix C, paras 17-29).

[180] See Waters 1984 at 700-01.

[228] The potential value of a provision based on UTIA section 7(4) is illustrated by a recent Alberta case, *Re Barabash Estate*.[181] In this case a number of allegations of impropriety or imprudence were made by beneficiaries against the administratrix (who, for our purposes, can be regarded as a trustee) of an estate. One of the allegations was that for a period of about ten months, the trustee failed to invest over $200,000 of estate funds. In fact, the funds in question had been held by the trustee's lawyer, and the lawyer had indeed failed to invest over $200,000 for a period of about ten months. Thus, "the estate lost interest income for this period of time."[182] It was held, however, that although the lawyer's failure to invest the funds manifested "poor judgment" on his part, it did not amount to negligence because he had provided a satisfactory explanation of why he had acted as he did. Moreover, the Court seems to have taken the view that even if the lawyer's failure to invest the funds had constituted negligence, the administratrix would not have been liable because she was not aware that the lawyer had failed to invest the funds.[183]

[229] The exact effect that sections 23 and 25 of the *Trustee Act* had on the outcome in *Re Barabash* is not altogether certain. When setting out the issues to be determined the judge, Lewis J., noted that the administratrix relied on sections 25 and 41 of the Act.[184] He then referred to Professor Waters' discussion of the uncertainty surrounding section 25, particularly, the meaning of the reference to "wilful default" in clause (d).[185] Lewis J. did not find it necessary to decide whether a trustee who is "merely" negligent in selecting, instructing or monitoring an agent could shelter behind section 25 because of its reference to wilful default. It would appear that Lewis J. found it unnecessary to decide this point because, in

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[181] [1999] A.J. No. 1012 (Q.B.), online: QL (CJ).

[182] *Ibid.*, at para. 41.

[183] *Ibid.* at paras 41-42; 54. Even if the administratrix had been negligent, Lewis J. would have exercised the discretion provided by section 41 of the *Trustee Act* to relieve her of liability: *ibid.* at para. 54.

[184] *Ibid.* at para. 11.

[185] *Ibid.* at paras 16-18.

his view, neither the lawyer (agent) nor the administratrix (trustee) had been negligent.[186]

[230] The judgment in *Barabash* does not contain a detailed analysis of the source of the administratrix's authority to delegate investment authority to a lawyer (or any other agent). Lewis J. notes that section 23 of the *Trustee Act* "enables the trustee to appoint agents and spells out when a trustee is responsible for a breach of trust by the agent."[187] The first two subsections[188] of section 23 read as follows:

> (1) A trustee may appoint a barrister and solicitor to be his agent to receive and give a discharge for any money or any valuable consideration or property receivable by the trustee under the trust, and no trustee is chargeable with breach of trust by reason only of his having made or concurred in making the appointment.
>
> (2) If a trustee permits the money, valuable consideration, or property to remain in the hands or under the control of the barrister and solicitor for a period longer than is reasonably necessary to enable the barrister and solicitor to pay or transfer it to the trustee, nothing in this section exempts the trustee from any liability that he would have incurred if this section had not been enacted.

The Court's discussion of the issue arising from the lawyer's failure to invest the trust funds seems to assume that section 23 provided the administratrix with authority to delegate responsibility for investing the funds to her lawyer.

[231] The Court appears not to have been invited to consider whether section 23 of the *Trustee Act* actually provides a trustee with authority to leave trust funds with an agent for an extended period of time and to leave decisions regarding the investment of trust funds during that period up to the agent. Given section 23(2), however, it is difficult to discern in the section a legislative intention to authorize a trustee to leave trust funds in the hands of an agent for any longer "than is reasonably necessary to enable the [agent] to pay or transfer it to the trustee." In other words, the section appears to authorize the trustee to use a lawyer (or bank or

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[186] *Ibid.* at para. 42.

[187] *Ibid.* at para. 12.

[188] Section 23 contains four subsections. Subsections (3) and (4) repeat subsections (1) and (3) with minor variations. Subsection (3) is identical to subsection (1) except that it refers to a "bank or treasury branch or a barrister and solicitor", and substitutes the phrase "any money payable to the trustee under or by virtue of a policy of assurance or otherwise" for subsection (1)'s "any money or any valuable consideration or property receivable by the trustee under the trust." Subsection (4) makes corresponding modifications to the wording of subsection (2).

treasury branch) as a conduit for getting funds into the trustee's hands, not as a long-term repository for or investment manager of such funds.[189]

[232] Our intention in commenting at some length on *Re Barabash Estate* is not to question its result. Rather, it is to illustrate why it would be useful for the *Trustee Act* to contain a provision based on UTIA section 7(5). Section 7(5) states that a trustee *who complies with section 7(3)* is not liable for an agent's decisions or actions. Thus, section 7(5) has the effect of emphasizing that although a trustee is not *vicariously* liable for an agent's decisions or actions, the trustee could incur liability for imprudence in selecting an agent, determining the terms of the delegated authority, or monitoring the agent.

[233] Provisions along the lines of UTIA section 7(2), (3) and (5) might not change the result in a case such as *Barabash*. However, this combination of provisions would provide a better framework for evaluating trustees' conduct with respect to the delegation of investment authority than is provided by the combination of sections 23 and 25 of the *Trustee Act*. Although not the most essential part of the framework, section 7(5) emphasizes that trustees who hope to avoid liability for an agent's actions must show that they have discharged their own duties under section 7(3).[190]

RECOMMENDATION No. 11

The Trustee Act should provide that a trustee who has properly delegated authority to an agent is not liable for the

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[189] See Waters 1984 at 701.

[190] We are confident that if the *Trustee Act* were amended to include provisions based on UTIA subsections 7(2), (3) and (5), it would be clear that a trustee who neglects their responsibilities under subsection 7(3) is liable for any loss suffered by the trust because of that neglect, notwithstanding section 25(d)'s reference to "wilful default." However, section 25 applies in contexts other than the investment context to which UTIA section 7 relates. Therefore, the problem of what section 25(d) means by "wilful default" could arise in contexts other than the delegation of investment authority. It is beyond the scope of this report to make recommendations regarding amendment of section 25. We observe, however, that a great deal of uncertainty could be removed simply by changing the wording of section 25(d) from "wilful default" to "neglect or default," which would make the wording of clause (d) consistent with the introductory wording of the section. Another approach would be to delete clauses (c) and (d), which is effectively what Saskatchewan did when it brought in the prudent investor rule: *Trustee Act*, R.S.S. 1978, c. T-23, s. 13, as am. by S.S. 1998, c. 40, s. 10. The Saskatchewan provision can now be paraphrased as saying that a trustee is not vicariously liable for the actions of other trustees or of agents, but only for the trustee's own "acts, receipts, neglects or defaults."

agent's decisions or actions if the trustee has discharged their duties relating to selection of the agent, establishing the terms of the delegated authority, and monitoring the agent's performance.

[234] We turn now to UTIA section 7(4). This provision, adopting the precise language of section 9(b) of the American UPIA, expressly imposes a duty of care on the agent in favour of "the trust." Saskatchewan's implementation of the UTIA states that the duty of care is owed to the trustee and the beneficiaries.[191] In its recent report the MLRC observes that in substituting "the trustee" for "the trust," the Saskatchewan provision reflects "the true legal nature of the trust."[192] What the Manitoba Commission has in mind with this observation is that under Canadian law a trust (unlike, a corporation) is not a legal person. Thus, the idea of an agent owing a duty to *a trust*, as distinguished from the trustee or the beneficiaries, is somewhat akin to the concept of someone owing a duty to *a contract*, as distinguished from a party to the contract.

[235] With respect to the Saskatchewan Act's statement that the agent owes a duty to the beneficiaries, the MLRC report explains that this statement was added "supposedly because this appears to be the Uniform Law Conference's intended meaning in subsection (4)."[193] The MLRC's reference to the *supposed* reason for the precise wording of the Saskatchewan provision, as an interpretation of the *apparently* intended meaning of UTIA section 7(4), demonstrates that the purpose and intended effect of the section is not altogether obvious. The commentaries on UPIA section 9(b) and UTIA section 7(4) are not exceptionally illuminating. The commentary on the former is as follows:

> Although subsection [9(c)] of the Act exonerates the trustee from personal responsibility for the agent's conduct when the delegation satisfies the standards of subsection 9(a), subsection 9(b) makes the agent responsible to the trust. The beneficiaries of the trust can, therefore, rely upon the trustee to enforce the terms of the delegation.

The commentary on UTIA section 7(4) says simply that it "is identical to s. 9(b) of [the UPIA]," without explaining what its intended purpose might be.

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[191] *Trustee Act*, R.S.S. 1978, c. T-23, s. 44(4), as am. by S.S. 1998, c. 40.

[192] MLRC 1999 at 22.

[193] *Ibid.*

[236] In its 1996 report to the ULCC that preceded the latter's adoption of the UTIA in 1997, the LRCBC made the following observation about the intent of UPIA section 9(b), and the possible effect of its adoption in Canada:

> Paragraph 9(b) creates a direct obligation owed by the agent to the trust, which the trustee may enforce despite being personally exonerated from liability for the agent's breach by paragraph 9(c). . . It might confer on the beneficiaries a direct right of action against the agent, regardless of whether or not the agent is or ought to be aware of the nature of the trust terms or even that trust property is involved. If so, it would be a significant widening of the responsibility of a trustee's agent in the common law provinces. An agent may attract trustee liability by knowingly effecting or assisting in a breach of trust or by interfering with the administration of a trust, but otherwise owes only a contractual obligation towards the trustee as principal. . . The direct obligation to the trust contemplated by paragraph 9(b) of the *Uniform Prudent Investor Act* would unquestionably improve the position of the beneficiaries and put beyond doubt the ability of any subsequent trustee to pursue the agent, but would also put business relationships between financial agents like brokers and investment managers, and the people who employ them, on a considerably different footing. It is a change that should only be made after carefully considering the effect it would have on those business relationships.[194]

The LRCBC report recommended that the ULCC adopt the UPIA's delegation powers without adopting either section 9(b) [agent's duty to trust] or section 9(c) [insulation of trustee from liability for agent's acts].[195]

[237] The concerns expressed by the LRCBC regarding the ramifications of imposing on agents a direct duty of care in favour of trust beneficiaries are reflected in Professor Waters' paper for the MLRC.[196] It is also reflected in the MLRC's report, which recommends that Manitoba's *Trustee Act* say nothing about the issue of the agent's liability to the trust (or to the trustee or the beneficiaries).[197]

[238] It is apparent that there is considerable doubt as to the purpose and effect of UTIA section 7(4). To the extent that it might be construed as conferring substantive rights on beneficiaries, there is a concern that it would open a can of worms that should not be opened without a great deal of prior reflection. On the

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[194] LRCBC 1996 at 14-15 (para. 53).

[195] *Ibid.* at 15 (para. 53).

[196] Waters 1998 at 28-30, 46-48.

[197] MLRC 1999 at 22-23.

other hand, it is likely that the purpose of section 7(4) is much more modest and merely procedural. Professor Waters discusses this possible purpose and indicates why, in his view, it is a purpose that does not need to be served by the statute:

> A trustee exculpated from personal liability for the agent's wrongdoing continues to hold in trust his contractual right of action to seek compensation from the agent because of the latter's breach. . . If for whatever reason the trustee refuses to bring action, the trust beneficiaries can sue the trustee, and in my opinion join the breaching agent as co-defendant . . .
>
> The [ULCC] would appear to have had some doubt as to whether such a joining is possible. The association between the trustee and the agent is contractual, so that they alone–it may have been thought–are party and privy to that contract. In the writer's opinion the privity of contract rule would not apply, because a trust beneficiary has an equitable proprietary interest in the trustee's right of contractual action against the third party.[198]

[239] We believe the intended purpose of UTIA section 7(4) is not to impose a substantive duty on agents in favour of trust beneficiaries. It is, rather, simply to remove a possible technical difficulty that might lie in the way of enforcement of a contractual claim that would exist apart from the section.[199] Given that this is what the section is intended to accomplish, there seems to be a more direct method of doing so. The *Trustee Act* should provide that an agent's liability for breach of a contract with a trustee can be enforced in an action by the trustee or, if the trustee fails to bring an action, by the beneficiaries. This will remove any doubt there might otherwise be about the beneficiaries' ability to enforce the agent's contractual obligations, should the need to do so arise. At the same time, it avoids a possible implication that the provision imposes substantive duties on the agent beyond those which the agent has agreed to assume under its contract with the trustee.

RECOMMENDATION No. 12

The *Trustee Act* should provide that loss suffered by a trust by reason of an agent's breach of a contract with a trustee may be recovered in an action by the trustee or, if the trustee fails to bring an action, in an action by beneficiaries.

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[198] Waters 1998 at 46-47.

[199] This interpretation seems to be consistent with the NCCUSL's commentary on UPIA section 9(b), quoted in para. 235, above.

[240] Before leaving this topic we address one last point. Suppose that the *Trustee Act* does not impose a duty of care on an agent in favour of the beneficiaries. The beneficiaries' rights against the agent would then ultimately depend upon the latter's contractual obligations to the trustee.[200] What happens if trustees have entered into a contract that severely restricts the agent's duties or the trustees' (and by implication the beneficiaries') remedies for breach of those duties? If the trustees are not liable (because the *Trustee Act* says they are not liable for the agent's actions) and the agent is not liable (because the contract says so), the beneficiaries could be without a remedy. An answer to this question is provided in the NCCUSL's Commentary on UPIA section 9:

> The trustee's duties of care, skill, and caution in framing the terms of the delegation should protect the beneficiary against overbroad delegation. For example, a trustee could not prudently agree to an investment management agreement containing an exculpation clause that leaves the trust without recourse against reckless mismanagement. Leaving one's beneficiaries remediless against willful wrongdoing is inconsistent with the duty to use care and caution in formulating the terms of the delegation.

We observe that although the foregoing passage refers to an exculpation clause that leaves the trust without recourse against "reckless mismanagement," it might also be imprudent for a trustee to enter into a contract that leaves the beneficiaries remediless in the face of negligent mismanagement.

6. Investment in Mutual Funds not Delegation

[241] We take it as uncontroversial that under the prudent investor rule a trustee should be able to invest in mutual funds. As mentioned earlier,[201] under existing law there are two reasons why trustees cannot safely invest in mutual funds unless expressly authorized by the trust instrument to do so. The first is that mutual funds are not mentioned in section 5 of the *Trustee Act*. This reason would fall away under the prudent investor approach.

[242] The second reason why trustees cannot safely invest in mutual funds is that there is authority to the effect that this would constitute an improper delegation of

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[200] It is quite possible that an agent of a trustee would owe an independent duty of care to the beneficiaries under principles of tort law. For the purposes of argument, however, we assume that the agent does not owe such a direct duty of care to the beneficiaries.

[201] See para. 128, above.

investment authority.[202] This is because selection of the underlying securities of a mutual fund is entrusted to the fund managers. Thus a trustee who invested in a mutual fund would be delegating to the fund managers discretionary authority that must be exercised by the trustee personally (unless expressly authorized by the trust instrument to do otherwise).

[243] UTIA subsection 7(7) addresses the delegation problem by providing specifically that investing in a mutual fund is not "a delegation of authority with respect to the investment of trust property." In one sense, subsection 7(7) is unnecessary, since trustees are given general authority to delegate decision-making to agents by subsection 7(2) . Thus, investment in mutual funds would be permissible even if it amounted to a delegation of authority to the fund's managers. However, if investing in mutual funds is viewed as delegation, this would give rise to the trustee's duties with respect to selection and oversight of an agent exercising delegated authority. Rather than treating the purchase of units of a mutual fund as delegation of investment authority, it seems more logical to treat it as an investment decision that must be evaluated in accordance with the standards of prudence that would apply to any other investment decision.

RECOMMENDATION No. 13
The *Trustee Act* should provide that purchase of securities issued by a mutual fund does not amount to delegation of investment authority by the trustee to the fund manager.

7. Section 9 of the Trustee Act

[244] Section 9(1) of the *Trustee Act* reads as follows:

> Except in the case of a security that cannot be registered, a trustee who invests in securities shall require the securities to be registered in his name as the trustee for the particular trust for which the securities are held, and the securities may be transferred only on the books of the corporation in his name as trustee for that trust estate.

Insofar as this section requires that a trustee be shown as the registered owner of a security on the books of the issuer, it is inconsistent with the modern reality of how

[202] *Haslam v. Haslam* (1994), 114 D.L.R. (4th) 562.

securities are held and transferred. The latter subject is dealt with in great detail in our report, *Transfers of Investment Securities*.[203]

[245] For present purposes, it suffices to observe that, nowadays, when a corporation issues securities to the public, the registered owner of the securities as shown in the records of the corporation is likely to be a *depository* (or its nominee). The depository, in turn, will maintain accounts on behalf of various *intermediaries*, such as securities brokers and financial institutions. The records of the depository will show the proportion of the securities that are held for it on behalf of different intermediaries. The records of the intermediaries, in turn, will show the proportion of the securities owned by particular clients of the intermediary. Under this system, it is only at the level of the intermediary's records where it is possible to indicate a typical trustee's ownership of securities.

[246] In its recent report the BCLI makes the following recommendation regarding the BC equivalent of section 9:

> Section 20 of the Trustee Act, which requires all trust securities capable of registration to be registered in the trustee's name as trustee for the particular trust, should be repealed to allow investment of trust property to be carried out through contemporary exchange trading methods, subject to a requirement that the holdings of the trust be identifiable at any given time.[204]

We regard it as uncontroversial that trustees should not be burdened with impractical registration requirements.

[247] It is one thing to dispense with the notion that the trustee must be shown as the registered owner of securities on the books of the issuer. It is quite another to dispense with the requirement that the trustee's status as trustee be shown on those records that do indicate the trustee's ownership of securities. The one does not entail the other. For example, where securities are held for a trustee by a broker, the requirement of section 9 could be translated into a requirement that the trustee require the broker's records to indicate that the securities are held by the broker for the trustee as trustee of the X trust. We believe that rather than simply repealing section 9, it should be amended or replaced. The new provision should be

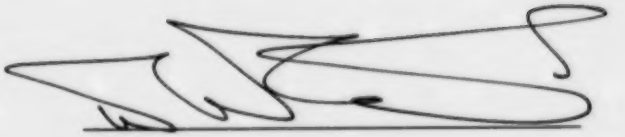
[203] ALRI 1993.

[204] BCLI 1999 at 22. The discussion leading up to this recommendation is at 4-5. MLRC 1999 at 28-29 reaches the same conclusion.

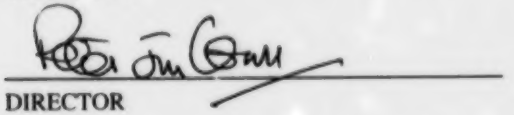
consistent with modern methods of securities transfer, but should retain the requirement that records indicating the trustee's ownership of securities indicate their status as trustee.

RECOMMENDATION No. 14
Section 9 of the Trustee Act should be amended so as to require trustees to ensure, so far as it is possible to do so, that any record evidencing their ownership of securities indicates their status as trustees, without presuming that the record will necessarily be an entry in the securities register of the issuer.

B.R. BURROWS
C.W. DALTON
A. DE VILLARS
A.D. FIELDING
N.A. FLATTERS
W.H. HURLBURT
H.J.L. IRWIN
P.J.M. LOWN
A.D. MACLEOD
S.L. MARTIN
D.R. OWRAM
B.L. RAWLINS
N.C. WITTMANN
R.J. WOOD



CHAIRMAN



DIRECTOR

February 2000

Appendix A

Trustee Act, Sections 2-13

The following sections appear under the heading "Investments" in the *Trustee Act*. Section 5 represents the core of the legal list approach. Most of the other provisions are in some way ancillary to the legal list approach, and could safely be repealed when the prudent investor rule is enacted. See Appendix C.

Definitions

2 In this section and sections 3 to 13,

(a) "approved corporation" means

(i) a corporation approved by the Lieutenant Governor in Council under this Act before July 1, 1966, whether the approval is a general one or is limited to a specified class or classes of security or to deposits,

(i.1) a loan corporation,

(ii) a corporation designated as an approved corporation pursuant to section 4,

(iii) a trust corporation, or

(iv) a credit union;

(b) "debentures" includes debenture stock;

(c) "improved real estate" means an estate in fee simple in land

(i) on which there exists a building, structure or other improvement used or capable of being used for residential, commercial or industrial purposes,

(ii) on which there is being erected such a building, structure or other improvement,

(iii) which is serviced with the utilities necessary for such a building, structure or other improvement, but only when the land is being mortgaged for the purpose of erecting the building, structure or other improvement, or

(iv) which is being used for agricultural purposes,

but does not include an estate in fee simple in mines or minerals held separately from the surface;

(d) "securities" includes stock, debentures, bonds, shares and guaranteed investment certificates or receipts.

Prior approvals

3(1) If a corporation was approved by the Lieutenant Governor in Council before July 1, 1966 and the approval is limited to a specified class of or classes of securities or to deposits, the corporation is, subject to subsection (2), an approved corporation for all purposes under section 5.

(2) Nothing in this section or section 5 shall be construed as enlarging the powers of an approved corporation in respect of the borrowing of money or the issuing of securities.

Approved corporation

4(1) The Lieutenant Governor in Council may designate a corporation as an approved corporation when it is shown to his satisfaction that the corporation

(a) is empowered to lend money on the security of real estate,

(b) has a subscribed and paid-up permanent capital of which at least $1 000 000 is unimpaired, and

(c) has a reserve fund derived solely from earnings and amounting to at least 25% of its paid-up capital.

(2) The Lieutenant Governor in Council may revoke an order approving a corporation or designating an approved corporation when he is satisfied

(a) that the corporation no longer has

(i) a subscribed and paid-up permanent capital of which at least $1 000 000 is unimpaired, or

(ii) a reserve fund derived solely from earnings and amounting to at least 25% of its paid-up capital,

(b) that the corporation is dissolved or is no longer carrying on business in Alberta,

(c) that the corporation has not kept strictly within its legal powers in relation to borrowing and investment, or

(d) that it is in the public interest to do so,

but the revocation does not affect the propriety of deposits or investments made before the revocation.

(3) An approved corporation, other than a trust corporation, loan corporation or credit union, shall file with the Executive Director

(a) a balance sheet, operating statement and any other supporting schedules as required by the Executive Director,

(b) a certified copy of its balance sheet as of the close of each fiscal year and the auditor's report on it within 170 days from the date to which it is made up, and

(c) any other statements, reports or other information pertaining to its financial position or affairs that the Executive Director requires.

(4) The balance sheet, operating statement and other supporting schedules referred to in subsection (3)(a) shall

(a) be filed with the Executive Director at a time and on a quarterly or monthly basis as he requires, and

(b) be in a form and certified in a manner approved by the Executive Director.

(5) In this section, "Executive Director" means the Executive Director as defined or otherwise provided for under the Securities Act.

Authorized trustee investments

5 A trustee may invest any trust money in his hands, if the investment is in all other respects reasonable and proper, in any of the following:

(a) securities of the Government of Canada, the government of any province of Canada, any municipal corporation in any province of Canada, the Government of the United Kingdom or the Government of the United States of America;

(b) securities, the payment of the principal and interest of which is guaranteed by the Government of Canada, the government of a province of Canada, a municipal corporation in any province of Canada, the Government of the United Kingdom or the Government of the United States of America;

(c) debentures issued by a school division, school district, drainage district, hospital district or health region under the Regional Health Authorities Act in Alberta that are secured by or payable out of rates or taxes;

(d) bonds, debentures or other evidences of indebtedness of a corporation that are secured by the assignment to a trustee of payments that the Government of Canada or the government of a province of Canada has agreed to make, if the payments are sufficient

(i) to meet the interest on all the bonds, debentures or other evidences of indebtedness outstanding as it falls due, and

(ii) to meet the principal amount of all the bonds, debentures or other evidences of indebtedness on maturity;

(e) bonds, debentures or other evidences of indebtedness

(i) of a corporation incorporated under the laws of Canada or a province of Canada that has earned and paid

(A) a dividend in each of the 5 years immediately preceding the date of investment at least equal to the specified annual rate on all of its preferred shares, or

(B) a dividend in each year of a period of 5 years ended less than one year before the date of investment on its common shares of at least 4% of the average value at which the shares were carried in the capital stock account of the corporation during the year in which the dividend was paid,

and

(ii) that are fully secured by a first mortgage, charge or hypothec to a trustee on any, or on any combination of the following assets,

(A) improved real estate,

(B) the plant or equipment of a corporation that is used in the transaction of its business, or

(C) bonds, debentures or other evidence of indebtedness or shares of a class or classes authorized by this section;

(f) bonds, debentures or other evidences of indebtedness issued by a corporation incorporated in Canada if at the date of the investment or loan the preferred shares or common shares of that corporation are authorized investments under clause (j) or (k);

(g) guaranteed investment certificates or receipts of a trust corporation;

(h) repealed 1989 c15 s6;

(i) bonds, debentures, notes or deposit receipts of an approved corporation;

(j) preferred shares of any corporation incorporated under the laws of Canada or of a province of Canada that has earned and paid

(i) a dividend in each of the 5 years immediately preceding the date of investment at least equal to the specified annual rate on all of its preferred shares, or

(ii) a dividend in each year of a period of 5 years ended less than one year before the date of investment on its common shares of at least 4% of the average value at which the shares were carried in the capital stock account of the corporation during the year in which the dividend was paid;

(k) fully paid common shares of a corporation incorporated in Canada or the United States of America that during a period of 5 years that ended less than one year before the date of investment has either

(i) paid a dividend in each of those years on its common shares, or

(ii) had earnings in each of those years available for the payment of a dividend on its common shares,

of at least 4% of the average value at which the shares were carried in the capital stock account of the corporation during the year in which the dividend was paid or in which the corporation had earnings available for the payment of dividends, as the case may be;

(l) shares of the Alberta Energy Company;

(m) notes or deposit receipts of banks;

(n) securities issued or guaranteed by the International Bank for Reconstruction and Development established by the Agreement for an International Bank for Reconstruction and Development, approved by the Bretton Woods Agreements Act (Canada), but only if the bonds, debentures or other securities are payable in the currency of Canada, the United Kingdom, any member of the British Commonwealth or the United States of America;

(o) securities issued or guaranteed by Inter-American Development Bank or by Asian Development Bank, but only if the bonds, debentures or other securities are payable in the currency of Canada or the United States of America;

(p) first mortgages, charges or hypothecs on improved real estate in Canada, but only if

(i) the loan does not exceed 75% of the value of the property at the time of the loan as established by a report as to the value of the property made by a person whom the trustee reasonably believed to be a competent valuator, instructed and employed independently of any owner of the property, or

(ii) the loan is an insured loan under the National Housing Act, 1954 (Canada).

Restrictions on investments

6(1) In determining market values of securities a trustee may rely on published market quotations of a recognized stock exchange in Canada or the United States of America.

(2) No corporation that is a trustee shall invest trust money in its own securities or lend money on the security of its own securities.

(3) In the case of an investment under section 5(e) the inclusion, as additional security under the mortgages, charges or hypothecs, of any other assets not of a class authorized by this Act as investments does not render the bonds, debentures or other evidences of indebtedness ineligible as an investment.

(4) No investment may be made under section 5(e), (i) or (j) that would at the time of making the investment cause the aggregate market value of the investments made under those clauses to exceed 35% of the market value at that time of the whole trust estate.

(5) Investments made by the testator or settlor and retained by the trustee under the authority of the trust instrument and that come within any of the classes authorized by section 5(e), (i) or (j) may, notwithstanding subsection (4), be retained by him under the authority of the trust instrument.

(6) No sale or other liquidation of any investment made under section 5(e), (i) or (j) is required solely because of any change in the ratio between the market value of those investments and the market value of the whole trust estate.

(7) In case of investment under section 5(j) or (k), not more than 30% of the total issue of shares of any corporation may be purchased for any trust.

(8) No investment shall be made under section 5(k) that, at the time of making the investment, would cause the aggregate market value of the common shares held for any particular trust fund to exceed 15% of the market value of that trust fund at that time.

(9) No sale or other liquidation of common shares is required under this section solely because of any change in the ratio between the market value of those shares and the market value of the whole trust fund.

Court approved trustee investments

7 In addition to the investments authorized by section 5 or by the trust instrument (except when that instrument expressly prohibits the investment), a trustee may invest funds in any other securities that the Court of Queen's Bench on application in any particular case approves as fit and proper, but nothing in this section relieves the trustee of his duty to take reasonable and proper care with respect to the investments so authorized.

Deposit of trust funds

8 A trustee may, pending the investment of any trust money, deposit it during a time that is reasonable in the circumstances

(a) in any bank or treasury branch,

(b) in any trust corporation,

(b.1) in any credit union,

(b.2) in any loan corporation, or

(c) in any approved corporation expressly empowered by statute to accept money for deposit.

Registration of securities

9(1) Except in the case of a security that cannot be registered, a trustee who invests in securities shall require the securities to be registered in his name as the trustee for the particular trust for which the securities are held, and the securities may be transferred only on the books of the corporation in his name as trustee for that trust estate.

(2) This section does not apply when the trustee is a trust corporation or the Teachers' Pension Plans Board of Trustees.

Statutory powers of trustee

10(1) The powers conferred by this Act relating to trustee investments are in addition to the powers conferred by the instrument, if any, creating the trust.

(2) Nothing in this Act relating to trustee investments authorizes a trustee to do any thing that he is in express terms forbidden to do or to omit to do any thing that he is in express terms directed to do by the instrument creating the trust.

Variation of investments

11(1) A trustee in his discretion may

(a) call in any trust funds invested in securities other than those authorized by this Act and invest the funds in securities authorized by this Act, and

(b) vary any investments authorized by this Act.

(2) No trustee is liable for a breach of trust by reason only of his continuing to hold an investment that since the acquisition thereof by the trustee has ceased to be one authorized by the instrument of trust or by this Act.

(3) When a trustee has improperly advanced trust money on a mortgage that would at the time of the investment have been a proper investment in all respects for a less sum than was actually advanced, the security shall be deemed to be an authorized investment for that less sum and the trustee is only liable to make good the amount advanced in excess thereof with interest.

Concurrence by trustee in corporate schemes

12(1) When a trustee holds securities of a corporation in which he has properly invested money under this Act, he may concur in any compromise, scheme or arrangement.

(a) for the reconstruction of the corporation or for the winding-up or sale or distribution of its assets,

(b) for the sale of all or any part of the property and undertaking of the corporation to another corporation,

(c) for the amalgamation of the corporation with another corporation,

(d) for the release, modification or variation of any rights, privileges or liabilities attached to the securities or any of them, or

(e) whereby

(i) all or a majority of the shares, stock, bonds, debentures and other securities of the corporation, or of any class thereof, are to be exchanged for shares, stock, bonds, debentures or other securities of another corporation, and

(ii) the trustee is to accept the shares, stock, bonds, debentures or other securities of the other corporation allotted to him pursuant to the compromise, scheme or arrangement,

in like manner as if he were entitled to the securities beneficially and may, if the securities are in all other respects reasonable and proper investments, accept any securities of any denomination or description of the reconstructed or purchasing or new corporation in lieu of or in exchange for all or any of the original securities.

(2) A trustee is not responsible for any loss occasioned by any act or thing done in good faith under subsection (1) and he may, if the securities accepted thereunder are in all other respects reasonable and proper investments, retain them for any period for which he could have properly retained the original securities.

Subscription for securities

13(1) If any conditional or preferential right to subscribe for any securities in any company is offered to a trustee in respect of any holding in the company, he may, as to all or any of the securities,

(a) exercise that right and apply capital money subject to the trust in payment of the consideration, or renounce the right, or

(b) assign for the best consideration that can be reasonably obtained the benefit of that right, or the title thereto, to any person, including any beneficiary under the trust,

without being responsible for any loss occasioned by any act or thing so done by him in good faith.

(2) Notwithstanding subsection (1), the consideration for any such assignment shall be held as capital money of the trust.

(3) The powers conferred by this section may only be exercised with the consent of any person whose consent to a change of investment is required by law or by the instrument, if any, creating the trust.

Appendix B

Enactments that Incorporate Trustee Act Investment Powers

Acts

Agricultural Societies Act, R.S.A. 1980, c. A-12, s. 28(1.2)
Cemeteries Act, R.S.A. 1980, c. C-2, ss 41(1), 55(4)
Condominium Property Act, R.S.A. 1980, c. C-22, s. 35
Dependent Adults Act, R.S.A. 1980, c. D-32, s. 29
Funeral Services Act, R.S.A. 1980, c. F-22.7, s. 6(3)
Historical Resources Act, R.S.A. 1980, c. H-8, s. 37
Irrigation Act, R.S.A. 1980, c. I-11, s. 48(3)
Livestock and Livestock Products Act, R.S.A. 1980, c. L-24, s. 14.5(2)
Opticians Act, R.S.A. 1980, c. O-8, s. 6(2)
Podiatry Act, R.S.A. 1980, c. P-11, s. 3(2)
Public Trustee Act, R.S.A. 1980, c. P-36, s. 27(5)
Real Estate Act, S.A. 1995, c. R-4.5, s. 57(1)
Safety Codes Act, S.A. 1991, c. S-0.5, s. 21(3)
School Act, S.A. 1988, c. S-3.1, s. 44(2)

Regulations

Automotive Business Regulation, Alta. Reg. 192/99, s. 26
LIS Delegated Authority Regulation, Alta. Reg. 219/98, s. 11(4)
LIS Delegated Authority Regulation, Alta. Reg. 221/98, s. 11(4)

Appendix C

Draft Prudent Investor Amendments to Trustee Act

The following draft legislative provisions are intended to show how our recommendations might be translated into legislative form. The first group of provisions is numbered as sections 2 through 8, on the basis that they would replace sections 2 through 13 of the current *Trustee Act*. The last provision is numbered as section 7.1 of the *Powers of Attorney Act*.

The draft provisions do not deal with one matter dealt with by the current sections 2-13 that might still need to be dealt with when the prudent investor approach replaces the legal list approach. Section 8 of the current Act authorizes trustees to deposit trust funds in certain types of financial institution pending their investment. Arguably, it is unnecessary to deal specifically with this matter under the prudent investor rule. The deposit of trust funds pending investment could be thought of as part of the overall investment process to which the prudent investor rule applies.

Nevertheless, it might be considered prudent to retain section 8 of the current Act. One of the types of financial institution mentioned by section 8 is an approved corporation expressly empowered to accept money for deposit. Therefore, if section 8 is retained, it will also be necessary to retain the provisions of the current Act that define the concept of an approved corporation and impose certain requirements on approved corporations. The relevant provisions are sections 2(a) and 4.

Draft *Trustee Act* Sections 2-9

Trust instrument governs

2 Sections 3 to 8 are subject to a contrary intention expressed in the instrument creating a trust.

> *Comment*
> Several of our recommendations and several provisions of the UTIA contain a qualification to the effect that the recommendation or provision is to apply subject to a contrary intention in the trust instrument. This global provision makes it unnecessary to repeat the "subject to" qualification at the beginning of each affected provision.

Application to pre-existing trusts

3 Sections 4 to 8 apply to a trust regardless of whether the trust was created before or after [the amending Act] comes into force.

> *Comment*
> See Recommendation 3. This section does not deal with the portion of Recommendation 3 that relates to enactments that define the investment powers of (non-trustee) fiduciaries by reference to the *Trustee Act*'s investment provisions. The relevant portion of Recommendation 3 is to the effect that such enactments should be interpreted as referring to the *Trustee Act* as amended. This portion of the recommendation would be given effect by ordinary principles of statutory interpretation.

Powers and duties with respect to investment

4(1) Any rules and principles of law or equity that impose a duty on a trustee exercising a power of investment continue to apply except to the extent that they are inconsistent with this or any other Act or the instrument creating the trust.

> *Comment*
> Section 4(1) is not based on a specific recommendation or a provision of the UTIA. Rather, the recommendations and the UTIA assume that rules of law or equity would continue to apply except to the extent of any inconsistency with the Act or instrument. This provision, which is based on provisions in the Australian Acts, would make this assumption explicit.

(2) A trustee may invest trust property in any form of property, provided that the investment is made in accordance with the requirements of this section.

> *Comment*
> See Recommendation 4.

(3) A trustee shall invest trust funds with a view to obtaining a reasonable return while avoiding undue risk, having regard to the circumstances of the trust.

> *Comment*
> See Recommendation 5(a).

(4) A trustee shall evaluate the expected return and risk associated with investment strategies or decisions within the context of the overall trust portfolio, rather than by focussing on particular investments in isolation.

Comment
See Recommendation 5(b).

(5) A trustee shall review the trust portfolio at reasonable intervals for the purpose of confirming that the portfolio continues to be appropriate to the circumstances of the trust.

Comment
See Recommendation 5(c).

(6) A trustee who has invested trust funds in property may exercise for the benefit of the trust any right or power that a person who was both the legal and beneficial owner of the trust's interest in the property could exercise.

Comment
This subsection is not based on a specific recommendation. It is intended to be a more concise and more comprehensive replacement for sections 12 and 13 of the current Act.

(7) Without restricting the matters that a trustee may consider, in planning the investment of trust funds a trustee shall consider the following matters, insofar as they are relevant to the circumstances of the trust:

(a) the purposes and probable duration of the trust, the total value of the trust's assets, and the needs and circumstances of the beneficiaries;
(b) the duty to act impartially towards beneficiaries and between different classes of beneficiaries;

(c) the special relationship or value of an asset to the purposes of the trust or to one or more of the beneficiaries;
(d) the possible effect of inflation or deflation;
(e) the need to maintain the real value of the capital or income of the trust;
(f) the need to maintain within the portfolio a balance that is appropriate to the circumstances of the trust between:
  (i) risk,
  (ii) expected total return from income and the appreciation of capital,
  (iii) liquidity, and
  (iv) regularity of income;
(g) the importance of diversifying the portfolio to an extent that is appropriate to the circumstances of the trust;
(h) the role that different investments or courses of action play within the overall portfolio; and
(i) the costs (such as commissions and fees) and expected tax consequences of investment decisions or strategies.

Comment
See Recommendation 6.

Trustee liability

5(1) A trustee is not liable for a loss in connection with the investment of trust property if the loss arises from a decision or course of action that a trustee of reasonable skill and prudence acting in accordance with section 4 might have made or adopted.

Comment
See Recommendation 7.

(2) A court assessing the damages payable by a trustee for a loss to the trust arising from the investment of trust property may take into account the overall performance of the investments.

Comment
See Recommendation 8. The wording is identical to UTIA section 5.

Delegation of investment authority

6(1) In this section, "agent" includes a stockbroker, investment dealer, investment counsel and any other person to whom investment responsibility is delegated by a trustee.

Comment
The wording is identical to UTIA section 7(1).

(2) A trustee may delegate to an agent the degree of authority with respect to investment of trust property that a prudent investor might delegate in accordance with ordinary investment practice.

Comment
See Recommendation 9. The wording is nearly identical to UTIA section 7(2). The term "investment" replaces "business" in the last line.

(3) A trustee who delegates authority under subsection (2) shall exercise prudence in

(a) selecting the agent,

(b) establishing the terms of the delegated authority, and

(c) in monitoring the performance of the agent to ensure compliance with the terms of the delegation.

Comment
See Recommendation 10. The wording is identical to UTIA section 7(3).

(4) A trustee who has delegated authority to an agent under subsection (2) and has complied with subsection (3) is not liable for the decisions or actions of that agent.

Comment
See Recommendation 11. The wording is very similar to UTIA section 7(5).

(5) Where investment authority has been delegated to an agent by a trustee and the trust suffers a loss because of the agent's breach of the agency contract, damages for the loss may be recovered from the agent in an action

(a) by the trustee, or

(b) by a beneficiary, if the trustee fails to commence an action within a reasonable time after acquiring knowledge of the breach.

Comment
See Recommendation 12.

Purchase of mutual fund units not delegation

7 Investment in a security issued by a mutual fund or similar investment vehicle is not a delegation of investment authority with respect to the investment of trust property.

Comment
See Recommendation 13. The wording is very similar to UTIA section 7(7). The latter refers to "a mutual fund as defined in [the *Securities Act*] or in a similar investment." Our *Securities Act* says that the term "mutual fund *includes*" certain things, but this definition is not very helpful for this purpose. We believe that the ordinary meaning of the term "mutual fund" is clear enough to serve the purposes of this section.

Recording of trust status

8(1) A trustee shall ensure, so far as it is practicable to do so, that any record evidencing the trustee's ownership of securities also indicates the trust relationship.

Comment
See Recommendation 14.

(2) Subsection (1) does not apply when the trustee is a trust corporation or the Teachers' Pension Plans Board of Trustees.

Comment
This reproduces section 9(2) of the current Act.

Draft *Powers of Attorney Act* Section 7.1

7.1 Sections 2 through 8 of the *Trustee Act* apply with any necessary modifications to an attorney exercising a power of investment under an enduring power of attorney.

Comment
See Recommendation 2.